

7-1996

***New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company.* The United States Supreme Court Gives Commercial Insurers a Severe Case of "The Blues"**

Mark A. Williams

Follow this and additional works at: https://digitalcommons.law.mercer.edu/jour_mlr

Recommended Citation

Williams, Mark A. (1996) "*New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company.* The United States Supreme Court Gives Commercial Insurers a Severe Case of "The Blues"," *Mercer Law Review*. Vol. 47 : No. 4 , Article 10.

Available at: https://digitalcommons.law.mercer.edu/jour_mlr/vol47/iss4/10

This Casenote is brought to you for free and open access by the Journals at Mercer Law School Digital Commons. It has been accepted for inclusion in Mercer Law Review by an authorized editor of Mercer Law School Digital Commons. For more information, please contact repository@law.mercer.edu.

New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company: The United States Supreme Court Gives Commercial Insurers a Severe Case of "The Blues"

In *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*,¹ the United States Supreme Court determined that the Employee Retirement Income Security Act of 1974 ("ERISA")² did not preempt a New York statute³ requiring hospitals to collect surcharges from patients covered by commercial insurers but not from patients insured by a Blue Cross/Blue Shield plan.⁴ The surcharge was part of New York's comprehensive regulatory scheme for controlling hospital rates.⁵ Patients are not charged for the cost of their individual treatment, but for the average cost of treating the patient's ailment, as classified under various Diagnostic Related Groups ("DRGs").⁶ Patients with coverage through Blue Cross/Blue Shield, Medicaid patients, and Health Maintenance Organization ("HMO") participants are billed at a hospital's DRG rate.⁷ Other patients, however, are billed at the hospital's DRG rate plus a surcharge which in some instances exceeds twenty-four percent of the applicable DRG rate.⁸ The statute also

1. 115 S. Ct. 1671 (1995).

2. 29 U.S.C. §§ 1001-1461 (1988 ed. & Supp. V 1995).

3. N.Y. PUB. HEALTH LAW § 2807-c (McKinney 1993).

4. 115 S. Ct. at 1674.

5. *Id.* The rates at issue were for all in-patient care, except for services provided to Medicare beneficiaries.

6. *Id.* These DRGs are adjusted for each hospital "to reflect its particular operating costs, capital investments, bad debts, costs of charity care and the like." *Id.*

7. *Id.* (citing N.Y. PUB. HEALTH LAW § 2807-c(1)(a) (McKinney 1993)).

8. *Id.* Patients served by commercial insurers providing in-patient hospital coverage on an expense-incurred basis, by self-insured funds directly reimbursing hospitals, and by certain workers' compensation, volunteer firefighters' benefit, ambulance workers' benefit, and no-fault motor vehicle insurance funds, must be billed at the DRG rate plus a 13% surcharge to be retained by the hospital. N.Y. PUB. HEALTH LAW § 2807-c(1)(b). Moreover, for the year ending March 31, 1993, hospitals were required to bill commercially insured

subjects various HMOs to surcharges that vary with the number of Medicaid recipients enrolled.⁹ Wanting to invalidate these surcharges, several commercial insurers, acting as fiduciaries for the ERISA plans they administer, joined with their trade associations and brought actions against various state officials in United States District Court for the Southern District of New York.¹⁰ The New York State Conference of Blue Cross and Blue Shield plans, Empire Blue Cross and Blue Shield (collectively "the Blues"), and the Hospital Association of New York State subsequently intervened as defendants.¹¹ Additionally, several HMOs and the New York State Health Maintenance Organization Conference intervened as plaintiffs.¹² The district court then consolidated the actions and granted the plaintiffs' motion for summary judgment, finding that the effect of these surcharges on choices by ERISA plans was enough to trigger preemption.¹³ The Court of Appeals for the Second Circuit affirmed, rejecting the decision of the Third Circuit in *United Wire, Metal & Machine Health & Welfare Fund v. Morristown Memorial Hospital*¹⁴ upholding a similar rate setting statute in New Jersey, and endorsed a broad interpretation of ERISA's pre-emption clause.¹⁵ The Supreme Court of the United States granted certiorari to resolve the conflict, and in a unanimous opinion reversed and remanded.¹⁶ The

patients for a further 11% surcharge to be turned over to the State. *Id.* § 2807-c(11)(i).

9. 115 S. Ct. at 1673. The surcharge on HMOs may run as high as 9% of the aggregate monthly charges paid by an HMO for its members' in-patient hospital care. N.Y. PUB. HEALTH LAW § 2807-c(2-a)(a) to (2-a)(e). "This charge is not an increase in the rates to be paid by an HMO to hospitals, but a direct payment by the HMO to the State's general fund." 115 S. Ct. at 1674.

10. 115 S. Ct. at 1675.

11. *Id.* at 1674.

12. *Id.*

13. *Id.* The district court found that even though the surcharges "do not directly increase a plan's costs or [a]ffect the level of benefits to be offered" there could be "little doubt that the [s]urcharges . . . could . . . lead . . . to an increase in plan costs." *Id.* Additionally, the court found that "the entire justification for the [s]urcharges [was] premised on that exact result." *Id.*

14. 995 F.2d 1179 (3d Cir. 1993), *cert. denied*, 510 U.S. 944 (1993).

15. 995 F.2d at 1179. The Second Circuit reasoned that ERISA preempted any state law that "purposefully interfere[d] with the choices that ERISA plans make for health care coverage." *Travelers Ins. Co. v. Cuomo*, 14 F.3d 708, 719 (2d Cir. 1993). Furthermore, the Second Circuit concluded that ERISA preempted any state law that "impose[d] a significant economic burden on commercial insurers and HMOs," especially when the law "substantially increase[d] the cost to ERISA plans of providing beneficiaries with a given level of health care benefits." *Id.* at 720-21.

16. 115 S. Ct. at 1675. On remand, the court of appeals reversed the judgment of the United States District Court for the Southern District of New York in part and remanded with instructions to enter judgment for the defendants on the issue of ERISA preemption of the surcharge statute. *Travelers Ins. Co. v. Pataki*, 63 F.3d 89, 95 (2d Cir. 1995).

Court backed away from its tradition of broadly interpreting ERISA's preemption clause, and held that "state laws [such as New York's] do not bear the requisite 'connection with' ERISA plans to trigger preemption."¹⁷ The Court, therefore, has now made it clear that in general, indirect economic effects do not "relate to" ERISA plans enough to invoke the preemption clause unless they produce "such acute, albeit indirect, economic effects, by intent or otherwise, as to force an ERISA plan to adopt a certain scheme of substantive coverage or effectively restrict its choice of insurers."¹⁸

Article VI of the United States Constitution provides, in part, that the laws of the United States "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any state to the Contrary notwithstanding."¹⁹ It has been well settled, since the Supreme Court's decision in *McCulloch v. Maryland*²⁰ in 1819, that any state law that conflicts with federal law is "without effect."²¹ The Court has further explained that preemption may occur either by implication, by express provision, by a direct conflict, or when federal law has so thoroughly occupied a legislative area that one can reasonably infer that Congress intentionally left no room for the States to supplement it.²² However, the Supreme Court has traditionally approached claims of preemption with the presumption that Congress does not intend to supplant state law.²³ This has been especially true regarding those areas that have traditionally been regulated by the states.²⁴ The Court has cautiously avoided preempting state law in a state's historic police power area unless that was the "clear and manifest purpose" of Congress.²⁵ In a nutshell, "[t]he purpose of Congress is the ultimate touchstone" of

17. 115 S. Ct. at 1680.

18. *Id.* at 1683.

19. U.S. CONST. art. VI. In its past decisions, the Court has explained that the Supremacy Clause may allow preemption of state law by express provision, implication, or a conflict between federal and state law. See *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190 (1983); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

20. 17 U.S. (4 Wheat.) 316 (1819).

21. *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981).

22. See, e.g., *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190 (1983); *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

23. See *Maryland v. Louisiana*, 451 U.S. 725 (1981).

24. See *id.*

25. *Rice*, 331 U.S. at 230. See, e.g., *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992); *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133 (1990); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985); *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977); *Napier v. Atlantic Coast Line R.R.*, 272 U.S. 605 (1926).

preemption analysis.²⁶ ERISA is a comprehensive statute that subjects plans providing employees with fringe benefits to federal regulation.²⁷ In short, it is designed to promote the interests of employees and their beneficiaries in employee benefit plans.²⁸ Section 514(a) of ERISA designates for preemption "all state laws insofar as they . . . relate to any employee benefit plan" ERISA covers.²⁹ The basic purpose of the preemption clause was to avoid a multiplicity of regulation in an attempt to provide for the nationally uniform administration of employee benefit plans.³⁰ Since ERISA's enactment, courts have been called upon to review the preemption clause a number of times.³¹ The Supreme Court has traditionally interpreted ERISA's preemption provision very broadly.³² For example, in *Shaw v. Delta Airlines, Inc.*,³³ the Court had to determine whether ERISA preempted New York's Human Rights Laws and the State's Disability Benefits Laws.³⁴ True to form, the Court endorsed a broad interpretation of ERISA's preemption clause and explained that a state law relates to an ERISA governed plan, within the meaning of section 514's reach, "if it has a connection with or reference to such a plan."³⁵ Furthermore, the Court declared that the phrase

26. *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978) (quoting *Retail Clerks v. Schermerhorn*, 375 U.S. 96 (1963)).

27. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983). An employee welfare-benefit plan or welfare plan is defined as one that provides to employees "medical, surgical, or hospital care or benefits, . . ." whether these benefits are provided "through the purchase of insurance or otherwise." 29 U.S.C. § 1002(1).

28. *Shaw*, 463 U.S. at 90. It does not, however, require employers to provide specific benefits, or by itself proscribe discrimination in the provision of employee benefits. *Id.*

29. 115 S. Ct. at 1677.

30. *Id.* at 1677-78.

31. *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125 (1992); *FMC Corp. v. Holliday*, 498 U.S. 52 (1990); *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133 (1990); *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825 (1988); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985); *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983); *United Wire, Metal & Machine Health & Welfare Fund v. Morristown Memorial Hosp.*, 995 F.2d 1179 (3d Cir. 1993); *Rebaldo v. Cuomo*, 749 F.2d 133 (2d Cir. 1984).

32. See, e.g., *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825 (1988); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985); *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983).

33. 463 U.S. 85 (1983).

34. *Id.* at 88. The Human Rights Law, N.Y. EXEC. LAW §§ 290-301 (McKinney 1982 & Supp. 1982-1983), is a comprehensive anti-discrimination statute that prohibits a number of things, including discrimination in employment on the basis of sex. The Disability Benefits Law, N.Y. WORK. COMP. LAW §§ 200-242 (McKinney 1965 & Supp. 1982-1983), requires employers to pay specific benefits to employees who are unable to work due to nonoccupational injuries or illness.

35. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 97 (1983).

"relates to" in section 514(a) is used "in the normal sense of the phrase."³⁶ The Court even cited the definition of "relate" in Black's Law Dictionary.³⁷ In *Shaw*, the Court did note, however, that "[s]ome state actions may affect employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan."³⁸ However, a state law may be preempted even though it has no direct nexus with ERISA plans, if its effect is to dictate or restrict the choices of ERISA plans with regard to their benefits, structure, reporting and administration, or if allowing states to have such rules would impair the ability of a plan to function simultaneously in a number of states.³⁹ Most notably, in *United*, the Third Circuit held that New Jersey's hospital rate setting statute, which is similar to New York's, did not relate to the plans in a way that would trigger ERISA's preemption clause.⁴⁰ The Third Circuit observed that a law relates to an ERISA plan if it is specifically designed to affect employee benefit plans, if it singles out such plans for special treatment, or if the rights or restrictions it creates are predicated on the existence of such a plan.⁴¹ In *United*, however, the Third Circuit was dealing with a statute of general application that was engineered to establish the prices to be paid for hospital services, which did not single out ERISA plans, and that functioned without regard to the existence of such plans.⁴² The Third Circuit held, therefore, that section 514 was not intended to frustrate the efforts of a state, using its police power, to regulate health care costs.⁴³ The Supreme Court embraced this approach.⁴⁴

In reaching its unanimous decision, the Supreme Court followed principles of dynamic statutory interpretation.⁴⁵ The Court began its attempt to determine Congress's intent by examining the text of the

36. *Id.* at 97.

37. *Id.* at 97 n.16.

38. *Id.* at 100 n.21.

39. See, e.g., *FMC Corp. v. Holliday*, 498 U.S. 52 (1990).

40. 995 F.2d 1179, 1196, *cert. denied*, 510 U.S. 944 (1993). The statutory and regulatory regime at issue in this case can be found in the New Jersey Health Care Facilities Planning Act of 1971, as amended by the Health Care Cost Reduction Act of 1978, N.J. STAT. ANN. 26:2H-1 to 26:2H-26 (West 1996) and the relevant regulations, N.J. ADMIN. CODE 8:31B (1990).

41. 995 F.2d at 1192; see also *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825 (1988); *Bricklayers Local 33 v. America's Marble Source*, 950 F.2d 114 (3d Cir. 1991); *McMahon v. McDowell*, 794 F.2d 100 (3d Cir. 1986).

42. 995 F.2d at 1192.

43. *Id.* at 1196.

44. 115 S. Ct. at 1683.

45. For an explanation of dynamic statutory interpretation, see Eskridge, *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479 (1987).

preemption provision.⁴⁶ More specifically, the Court analyzed that portion that says, "all state laws insofar as they . . . relate to any employee benefit plan" covered by ERISA.⁴⁷ The Court first noted that this portion of the text of section 514(a) was expansive,⁴⁸ so expansive in fact that if taken literally, the words of limitation would not do much limiting.⁴⁹ The Court concluded that such a reading would result in Congress's words of limitation being nothing more than a mere sham, reading the presumption against preemption out of the law whenever Congress speaks to the matter with generality.⁵⁰ The Court then conceded that previous attempts to construe the phrase "relate to" did not provide much assistance in this case.⁵¹ The Court then turned to its decision in *Shaw*, in which it interpreted the preemption clause very broadly.⁵² The Court explained that "[a] law 'relates to' an employee benefit plan, if it has a connection with or reference to such a plan."⁵³ The Court immediately ruled out the latter alternative because the surcharges are imposed on patients regardless of whether an ERISA plan ultimately secures their insurance coverage; therefore, the statutes could not be said to make "reference to" ERISA plans in any manner.⁵⁴ Still left with the question of whether the surcharge statutes had a "connection with" the ERISA plans, the Court stated that just as infinite relations could not form the basis for preemption, neither could infinite connections.⁵⁵ The Court, therefore, had to move beyond the text of section 514(a) and look to the objectives of ERISA to determine the scope of state laws that Congress intended to survive.⁵⁶ After examining past decisions and a statement by the sponsor of the Act, the Court concluded that the basic thrust of the preemption clause was to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans.⁵⁷ The Court then reasoned that while there

46. 115 S. Ct. at 1677.

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85 (1983).

53. *Id.* at 96-97.

54. 115 S. Ct. at 1677. *Cf.* *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125 (1992) (striking down a District of Columbia law that "specifically refers to welfare benefit plans regulated by ERISA and on that basis alone is pre-empted").

55. 115 S. Ct. at 1677.

56. *Id.*

57. *Id.* at 1677-78. In a previous decision, the Court had already found that in passing § 514(a), Congress intended:

was no evidence that New York's surcharges would drive each and every health insurance consumer to the Blues, they nonetheless make the Blues more attractive as insurance alternatives, and result in an indirect economic effect on choices insurance buyers make—including ERISA plans.⁵⁸ The Court concluded, however, that an indirect economic influence does not bind plan administrators to any particular plan and therefore does not function as a regulation of an ERISA plan.⁵⁹ Moreover, the Court concluded that the indirect influence of the surcharges would not preclude uniform administrative practice or the provision of a uniform interstate benefit package, if a plan wished to provide one.⁶⁰ The Court thought that if it were to read the preemption provision as uprooting all state laws affecting hospital costs and charges on the supposition that they indirectly relate to ERISA plans, it would in essence be reading the limiting language in section 514(a) out of the statute. Such a result would violate the basic principles of statutory interpretation and would not be in accord with the Court's prior pronouncement that "[p]reemption does not occur . . . if the state law has only a tenuous, remote, or peripheral connection with covered plans, as is the case with many laws of general applicability."⁶¹ The Court further noted that even though Congress's extension of preemption to all "state laws relating to benefit plans" was meant to be broader than "state laws dealing with the subject matters covered by ERISA—reporting, disclosure, fiduciary responsibility, and the like,"⁶² there was nothing in either the language of the Act or the context of its passage to indicate that Congress chose to preempt general health care regulation, which has historically been a matter of local concern.⁶³ The Court therefore came to the conclusion that surcharge statutes such as New

to ensure that plans and plan sponsors would be subject to a uniform body of benefits law; the goal was to minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government, . . . [and to prevent] the potential for conflict in substantive law . . . requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction.

Id. at 1677 (quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 142 (1990)). This conclusion was further confirmed by a statement of Representative Dent, a sponsor of the Act, that the objective was to "eliminat[e] the threat of conflicting and inconsistent State and local regulation." 120 CONG. REC. 29197 (1974).

58. 115 S. Ct. at 1679.

59. *Id.*

60. *Id.*

61. *Id.* at 1679-80 (quoting *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125, 129 n.1 (1992)).

62. *Shaw*, 463 U.S. at 98 & n.19.

63. 115 S. Ct. at 1680.

York's do not bear the requisite connection with ERISA plans to trigger preemption.⁶⁴ The Court intentionally avoided addressing the thirteen percent surcharge statute insofar as it applied to self-insured funds and left the issue for consideration on remand.⁶⁵

This decision appears to signal that the Court is retreating from its past practice of broadly interpreting ERISA's preemption clause. This past practice led many to believe that *Travelers* would be decided differently, and that New York's statute would indeed be preempted. The Court made it clear, however, that in general, indirect economic effects do not relate to ERISA plans enough to invoke the preemption clause.⁶⁶ The Court stressed, however, that its ruling does not limit ERISA preemption only to direct regulation of ERISA plans and that there may be instances where an indirect effect may trigger preemption.⁶⁷ Exactly at what point an indirect economic effect significantly impacts a plan to trigger preemption is not yet known. Furthermore, the Court left a loophole for self-insured funds.⁶⁸ On remand, however, the Second Circuit closed the loophole for that circuit by ruling that if a regulation did not relate to a non-self-insured plan it would not relate to a self-insured plan either.⁶⁹ Many have seen ERISA preemption as a major obstacle to state efforts to control spiraling health care costs.⁷⁰ One has to wonder if the increased national attention that the media and others have placed on health care in recent years was the real impetus behind the Court's dramatic move. Through this opinion, however, the Supreme Court has not only resolved the conflict between the Second and Third Circuits on this issue, it has given other states the green light to implement similar rate setting programs. Whether other states will follow New York's lead, however, is a different issue; although, some states eagerly awaited this decision. For example, Connecticut imposed a tax on hospitals' gross receipts that was then used to reimburse the hospitals for the costs of their uncompensated care.⁷¹ In *Connecticut Hospital Ass'n v. Pogue*,⁷² a federal judge relied

64. *Id.*

65. *Id.* at 1675 n.4.

66. *Id.* at 1683.

67. *See id.* The Court acknowledged "that a state law might produce such acute, albeit indirect, economic effects, by intent or otherwise, as to force an ERISA plan to adopt a certain scheme of substantive coverage or effectively restrict its choice of insurers, and that such a state law might indeed be shown to be pre-empted under [section] 514." *Id.*

68. 115 S. Ct. at 1675 n.4.

69. *See Travelers Ins. Co. v. Pataki*, 63 F.3d 89 (2d Cir. 1995).

70. Michael S. Gordon, *Managed Care, ERISA Pre-emption, and Health Reform—The Current Outlook*, 4 BHLR 16 d44 (1995).

71. 1994 Conn. Acts 94-9 (Reg. Sess.).

72. 870 F. Supp. 444 (D. Conn. 1994).

on the Second Circuit's decision in this case and struck down the tax and reimbursement plan, saying that ERISA preempted the plan.⁷³ Similarly, in *New England Health Care Employees Union District 1199 v. Mount Sinai Hospital*,⁷⁴ a federal judge found ERISA to preempt a prior Connecticut uncompensated care arrangement.⁷⁵ In light of the Supreme Court's ruling in *Travelers*, the Second Circuit reversed both decisions on appeal.⁷⁶ The effect that *Travelers* will ultimately have on the nation's health care costs remains to be seen. While rate setting statutes may be intended to control the overall costs of healthcare, they inarguably have a negative effect on commercial insurers, or at least their subscribers who ultimately pay the price through increased premiums. Through rate setting statutes, states can force commercial insurers, and thus their subscribers, to subsidize the health care expenses of others. Unfortunately, though, if this form of cross-subsidation was not taken advantage of, the funds for uncompensated care would have to come from another source, such as taxes. The bottom line of *Travelers*, however, is that the Supreme Court has strengthened states' ability to regulate hospital rates. As long as the regulation simply affects "a plan's shopping decisions" and does "not bind plan administrators to any particular choice," *Travelers* would seem to say that it should not be preempted.⁷⁷ Therefore, under *Travelers*, states may indeed create rate differentials that influence such choices.⁷⁸

MARK A. WILLIAMS

73. *Id.* at 444.

74. 846 F. Supp. 190 (D. Conn. 1994).

75. *Id.* at 190.

76. See *New England Health Care Employees Union v. Mount Sinai Hosp.*, 65 F.3d 1024 (2d Cir. 1995); and *Community Hosp. Assoc. v. Weltman*, 66 F.3d 413 (2d Cir. 1995).

77. 115 S. Ct. at 1679.

78. *Travelers Ins. Co. v. Pataki*, 63 F.3d 89, 94 (2d Cir. 1995).

