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Adjusting the Benefits and Burdens of Economic Life for the Public Good: The ACA's Medical Loss Ratio as a Constitutional Regulation of Health Insurance Companies

Susanne Cordner

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ADJUSTING THE BENEFITS AND BURDENS OF ECONOMIC LIFE FOR THE PUBLIC GOOD: THE ACA’S MEDICAL LOSS RATIO AS A CONSTITUTIONAL REGULATION OF HEALTH INSURANCE COMPANIES

Susanne Cordner*

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INTRODUCTION

This Note examines one of the more recent potential challenges that academia has raised to the Patient Protection and Affordable Care Act (ACA): the minimum Medical Loss Ratio (MLR) as an unconstitutional taking of property under the Fifth Amendment. This Note argues that, under the appropriate constitutional analysis, the MLR *does not* rise to the level of a taking.¹

The ACA was enacted to address two primary problems in the American health-care industry: access and affordability.² Before the ACA was enacted, over 47 million Americans—18% of the population—did not have health insurance.³ The main barrier to coverage was cost: most people who did not have health care usually did not have access to employer health insurance, and could not afford to purchase it on their own.⁴ Additionally, lack of coverage was a long-term problem for most uninsured, with 47% reporting that they had been uninsured for five years or more, and 18% reporting that they had never had any coverage at all.⁵ Uninsured Americans had few ways to get affordable health care. Most Americans obtain health insurance through their employer, but 80% of uninsured Americans had no access to employer insurance, and most of the remaining 20% reported that the employer insurance was too expensive.⁶

Despite the number of uninsured individuals, over the last thirty years, healthcare spending in the United States has snowballed.⁷ Americans spend more per year on

¹ See *infra* Part IV.

² *ObamaCare Summary: Obama Health Care Summary*, OBAMACARE FACTS, <http://obamacarefacts.com/obamahealthcare-summary/> [<http://perma.cc/FZ5S-Q39V>] [hereinafter *ObamaCare Summary*].

³ Rachel Garfield, Rachel Licata & Katherine Young, *The Uninsured at the Starting Line: Findings from the 2013 Kaiser Survey of Low-Income Americans and the ACA*, KAISER FAM. FOUND. (Feb. 6, 2014), <http://kff.org/uninsured/report/the-uninsured-at-the-starting-line-findings-from-the-2013-kaiser-survey-of-low-income-americans-and-the-aca/> [<http://perma.cc/9NW8-LNXG>].

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ If the U.S. healthcare system was a country, it would be the fifth largest economy in the world. Ezekiel J. Emanuel, *Spending More Doesn't Make Us Healthier*, N.Y. TIMES: OPINIONATOR (Oct. 27, 2011, 12:53 PM), <http://opinionator.blogs.nytimes.com/2011/10/27/spending-more-doesnt-make-us-healthier/> [<http://perma.cc/39T8-W4L7>].

healthcare costs than people in any other country with comparable per capita income levels.⁸ Additionally, the rate at which that number is growing is increasing quickly—faster than overall economic growth and the rate of inflation.⁹ This means that each year, Americans spend a larger percentage of their income on healthcare costs.

The ACA has many provisions designed to make insurance accessible to individuals at a lower cost.¹⁰ However, the MLR is one of the only provisions that directly targets the rising costs of health insurance.¹¹ The MLR limits the amount of premium dollars a health insurance company may spend on administrative costs, overhead, and profit by requiring that companies spend a specified portion of the money they receive in premium payments (85% for all large group business and 80% for all small group and individual business) on paying claims and quality healthcare improvements.¹² The constitutional challenge to the MLR lies in the effective cap the MLR puts on profits by requiring health insurers to spend a large, specific portion of their total revenue on health-related and nonadministrative expenses, unconstitutionally limiting the rate of return that health insurers can receive, and violating the Takings Clause of the Fifth Amendment.

Although the ACA has attracted a lot of attention since its passage in 2010, very little work has examined the MLR.¹³ Moreover, none of the work has examined the MLR as a taking under any doctrine other than that applied in the public utility rate-making context. This Note argues that the public utility analysis is not the appropriate analysis to apply to the MLR.¹⁴ Public utilities have a unique status as monopolies. Because of this status, they are highly regulated, partially in order to approximate the rates that would occur in a competitive market.¹⁵ The balance to this rate regulation is that they are granted a constitutionally protected rate of return on their investment.¹⁶

⁸ *Snapshots: Health Care Spending in the United States & Selected OECD Countries*, KAISER FAM. FOUND. (Apr. 12, 2011), <http://kff.org/health-costs/issue-brief/snapshots-health-care-spending-in-the-united-states-selected-oecd-countries/> [<http://perma.cc/4XZQ-VUNP>].

⁹ *Id.* In 1980, Americans spent 9% of the GDP on healthcare spending; in 2008, they spent 16% of the GDP. *Id.*

¹⁰ See *infra* notes 52–58 and accompanying text (discussing ACA provisions designed to lower the cost of insurance for individuals previously unable to purchase insurance).

¹¹ See *ObamaCare Rate Review & The 80/20 Rule*, OBAMACARE FACTS, <http://obamacarefacts.com/obamacare-rate-review-80-20-rule/> [<http://perma.cc/55H6-DYBL>] (“ObamaCare’s rate review provision and the 80/20 rule help curb premium growth and keep insurance affordable.”).

¹² See *infra* notes 62–81 and accompanying text.

¹³ See *infra* Part II.B.

¹⁴ See *infra* Part IV.A.

¹⁵ See generally Richard A. Epstein, *Impermissible Ratemaking in Health-Insurance Reform: Why the Reid Bill Is Unconstitutional*, MED. PROGRESS TODAY (Dec. 18, 2009), <http://www.law.uchicago.edu/news/epstein121809> [<http://perma.cc/QXS7-P6TU>].

¹⁶ See generally Richard A. Epstein & Paula M. Stannard, *Constitutional Ratemaking and the Affordable Care Act: A New Source of Vulnerability*, 38 AM. J.L. & MED. 243, 265–66 (2012).

In contrast to public utilities, health insurance companies exist in a highly competitive—albeit also highly regulated—market. The constitutional analysis that applies to public utilities is thus not appropriately applied to health insurance companies. Any insurance company rate regulation should be examined under the general regulatory takings standard governed by *Penn Central Transportation Co. v. New York City*.¹⁷ Under this constitutional analysis, the MLR does not rise to the level of an unconstitutional taking.¹⁸

Part I will provide an overview of the sections of the ACA that are relevant in examining the effect the MLR will have on health insurance companies.¹⁹ Part II will provide a brief overview of the existing scholarship regarding the MLR, addressing why the MLR is a legitimate constitutional issue and including a discussion of the leading arguments for its unconstitutionality.²⁰ Part III will give an overview of the constitutional doctrine of takings, specifically examining the different analyses applied to public utilities and regulatory takings.²¹ Part IV will argue that the regulatory takings analysis is the analysis that should be applied to any constitutional challenge of the MLR as a taking and will discuss why the MLR does not rise to the level of a taking under that analysis.²²

I. EXPLANATION OF THE ACA

The Patient Protection and Affordable Care Act²³ (ACA) was signed into law by President Obama on March 23, 2010, after passing the Senate with a vote of 60–39,²⁴ and the House with a vote of 219–212.²⁵ The ACA has been a source of controversy and contention since its inception.²⁶ Since it passed in 2010, House opponents of the law have led fifty-four votes to overturn, defund, or limit the law.²⁷ There is a website

¹⁷ 438 U.S. 104 (1978) [hereinafter *Penn Central*].

¹⁸ See *infra* Part IV.B.

¹⁹ See *infra* Part I.

²⁰ See *infra* Part II.

²¹ See *infra* Part III.

²² See *infra* Part IV.

²³ Patient Protection and Affordable Care Act, Pub L. No. 111-148, 124 Stat. 119 (2010) [hereinafter ACA].

²⁴ H.R. 3590 (111th): Patient Protection and Affordable Care Act, GOVTRACK.US, <https://www.govtrack.us/congress/votes/111-2009/s396> [<http://perma.cc/7N8D-XQMJ>]

²⁵ H.R. 3590 (111th): Patient Protection and Affordable Care Act, GOVTRACK.US, <https://www.govtrack.us/congress/votes/111-2010/h165> [<http://perma.cc/Y3HU-EMG9>].

²⁶ See, e.g., Julie Rovner, *At Age 3, Affordable Care Act is No Less Controversial*, NAT. PUB. RADIO (Mar. 23, 2013 6:18 AM), <http://www.npr.org/blogs/health/2013/03/23/175099334/at-age-3-affordable-care-act-is-no-less-controversial> [<http://perma.cc/8VVJ-Y2AM>].

²⁷ Ed O'Keefe, *The House Has Voted 54 Times in Four Years on Obamacare*, WASH. POST (Mar. 21, 2014), <http://www.washingtonpost.com/news/the-fix/wp/2014/03/21/the-house-has-voted-54-times-in-four-years-on-obamacare-heres-the-full-list/> [<http://perma.cc/T7RB-ZEWN>].

devoted entirely to tracking and discussing pending and decided legal challenges to the legislation.²⁸ This website reports sixty separate lawsuits challenging various aspects of the ACA.²⁹

In addition to being controversial, the law is complex. It is over one thousand pages long and contains the most extensive reforms of the health insurance industry since the creation of Medicare and Medicaid in 1965.³⁰ Through its complex and comprehensive regulation, the ACA essentially regulates two major areas: (1) individual and employer participation in the healthcare market, and (2) health insurers' behavior in the healthcare industry.³¹

A. Individual Regulation³²

The most widely discussed individual reform in the ACA is the Minimum Essential Coverage Provision, or individual mandate.³³ The individual mandate "requires most Americans to maintain 'minimum essential' health insurance coverage."³⁴ The effect of the provision is to force individuals who currently do not pay for health insurance to purchase health insurance (at a subsidized rate if their income is low enough) or pay a penalty.³⁵

In order to manage this mass influx of consumers in the market for insurance, the ACA created State Exchange Programs to "facilitate[] the purchase of qualified health plans."³⁶ The only way for insurers to access consumers who qualify for federal subsidies is by joining the State Exchange Program.³⁷

²⁸ HEALTHCARELAWSUITS.ORG, <http://healthcarelawsuits.org/> [<http://perma.cc/LZM7-J769>] ("Health Care Lawsuits is an informational resource on legal challenges to the Affordable Care Act.").

²⁹ HEALTHCARELAWSUITS.ORG, <http://healthcarelawsuits.org/case-archive.php> [<http://perma.cc/V4XR-RDBB>]. Many are multistate lawsuits that consolidate numerous plaintiffs suing about the same issue. *See id.*

³⁰ Scott E. Harrington, *U.S. Health-Care Reform: The Patient Protection and Affordable Care Act*, 77(3) J. RISK & INS. 703, 703 (2010).

³¹ *See, e.g., ObamaCare Summary*, *supra* note 2 ("Obamacare . . . reforms the health insurance industry and the American health care system as a whole. The law . . . give[s] Americans more rights and protections and expand[s] access to affordable quality healthcare . . .").

³² This Note will briefly discuss the individual regulations that are necessary to understand the effect of the MLR as a whole, but it will focus on the regulations that affect health insurers' behavior in the healthcare industry as that is the part of the law that is the most applicable to the MLR. Additionally, although the ACA sets forth substantial regulations relating to employers, this Note will not discuss those regulations. A full discussion of the ACA is outside the scope of this Note, and only those provisions that substantially affect the operation of the MLR will be discussed.

³³ ACA, Pub. L. No. 111-148, § 1501, 124 Stat. 119, 242-44 (2010).

³⁴ *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

³⁵ *Id.*

³⁶ § 1311, 124 Stat. at 173.

³⁷ *Id.* Once a health insurance company has joined the State Exchange Program, it is subject to extensive federal regulation. *See generally* Rebecca J. Kopps, Note, *Dead on Arrival: The*

B. Health Insurance Company Regulation

The core analytical task of an insurance enterprise is identifying future losses, choosing which of those losses it is willing to insure, estimating the frequency and magnitude of those events, preparing insurance contracts that reflect those choices, and then deciding how much to charge which classes of people in return for this protection.³⁸

Although the individual participation side has, to date, received the most attention and been the subject of the most controversy,³⁹ the ACA's federal regulation of health insurance companies is just as unprecedented and just as far-reaching as its regulation of individual behavior. The ACA regulates every major aspect of the health insurance business and strongly limits the ways in which health insurers may engage in each of the core analytical tasks of insurance.

1. Identifying Future Losses

The ACA heavily regulates health insurers' underwriting process.⁴⁰ Insurance underwriting is "[t]he process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify."⁴¹ Underwriting is generally considered the way in which an insurance company manages the risk it takes on when entering into an insurance contract: by accurately identifying how likely an individual insured is to incur costs (make claims), the insurance company can charge that individual the appropriate amount for the insurance coverage.⁴²

Prior to the passage of the ACA, insurers considered a variety of factors in determining whether to grant coverage and what the rate of coverage would be for an applicant. These factors included, among other things, an applicant's age, gender, and medical history.⁴³ Health insurers also limited the risk they assumed in insuring

Health Insurance Industry's Bleak Prognosis Due to Unconstitutional Ratemaking in the Patient Protection and Affordable Care Act, 31 N. ILL. U. L. REV. 577 (2011); Meghan S. Stubblebine, *The Federal Medical Loss Ratio: A Permissible Federal Regulation or an Encroachment on State Power?*, 55 WM. & MARY L. REV. 341 (2013); Epstein, *supra* note 15.

³⁸ TOM BAKER & KYLE LOGUE, *INSURANCE LAW AND POLICY* 16 (3d ed. 2013); *see also* 1 COUCH ON INSURANCE 16–18 (2014) ("Insurance has been defined . . . [as] a contract whereby one party promises for a consideration to indemnify the other against certain risks.").

³⁹ *See, e.g., Sebelius*, 132 S. Ct. 2566.

⁴⁰ §§ 2701–2708, 124 Stat. at 155–61; *see also* Kopps, *supra* note 37, at 583–84.

⁴¹ LEO P. MARTINEZ & JOHN W. WHELAN, *CASES AND MATERIALS ON GENERAL PRACTICE INSURANCE LAW* 8 (4th ed. 2001); *see also Underwriting*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("The act of assuming a risk by insuring it.").

⁴² *See* BAKER & LOGUE, *supra* note 38, at 1–11 (discussing risk, risk spreading, and moral hazard, and how insurance companies manage those aspects of the business).

⁴³ Kopps, *supra* note 37, at 583.

individuals by including exclusions for preexisting conditions or cancelling individual policies when the individual became riskier than the company's initial assessment.⁴⁴

Under the ACA, insurers may consider only four factors when setting rates: whether the plan is an individual or family plan, geographic location, age, and tobacco use.⁴⁵ An age rating may not increase an individual's premium by more than a factor of 3, and tobacco use may not increase an individual's premium by more than a factor of 1.5.⁴⁶ Additionally, the ACA expressly prohibits health insurers from underwriting on the basis of "health status," "[m]edical condition (including both physical and mental illnesses)," "[c]laims experience," "[r]eceipt of health care," "[m]edical history," "[g]enetic information," "[e]vidence of insurability," "[d]isability," or "[a]ny other health-status related factor determined appropriate by the Secretary."⁴⁷ This removes from the health insurers the traditional factors used to assess an individual's risk and base premiums on that risk.

The effect of the ACA's drastic limitations on health insurance underwriting is twofold. One, health insurers no longer have a way to ensure that the premiums they charge individuals are commensurate to the amount of claims that an individual will be making.⁴⁸ In addition, the risk of adverse selection⁴⁹ in individuals purchasing health insurance is much higher under the ACA because health insurers are no longer able to employ many of the tools they have historically used to mitigate that risk.⁵⁰

2. Choosing Which Losses to Insure

The ACA also prohibits health insurance companies from managing their risk by refusing to insure high-risk individuals: "each health insurance issuer that offers health insurance coverage in the individual or group market in a State must accept every employer and individual in the State that applies for such coverage."⁵¹ Further, the Act prohibits insurers from limiting their risk by refusing to insure preexisting conditions: "A group health plan and a health insurance issuer offering group or

⁴⁴ *Id.*

⁴⁵ § 2701(a)(1)(A)(i)–(iv), 124 Stat. at 155.

⁴⁶ *Id.* § 2701(a)(1)(A)(iii)–(iv), 124 Stat. at 155.

⁴⁷ *Id.* § 2705(a)(1)–(9), 124 Stat. at 156.

⁴⁸ See *Medical Underwriting*, HEALTHCARE.GOV, <https://www.healthcare.gov/glossary/medical-underwriting/> [<http://perma.cc/ZEJ4-LAAJ>] ("A process used by insurance companies to try to figure out your health status when you're applying for health insurance coverage to determine whether to offer you coverage, at what price, and with what exclusions or limits.").

⁴⁹ See BAKER & LOGUE, *supra* note 38, at 12 ("[A]dverse selection typically refers to the (theoretical) tendency for high-risk people to be more interested in insurance than low-risk people are. . . . The theoretical result of adverse selection is that the average risk level of people who choose to purchase insurance will be higher than the average level of risk of the population as a whole.").

⁵⁰ See generally *id.* at 8–9 (discussing premium differentials, deductibles and co-payments, and exclusions and cancellations as ways in which insurance companies manage risk).

⁵¹ ACA, Pub. L. No. 111-148, § 2702(a), 124 Stat. 119, 156 (2010).

individual health insurance coverage may not impose any preexisting condition exclusion with respect to such plan or coverage.”⁵²

The ACA also requires that each individual and small-group plan sold contain coverage for certain essential benefits.⁵³ This “essential health benefits package” includes coverage for “[a]mbulatory patient services,” “[e]mergency services,” “[h]ospitalization,” “[m]aternity and newborn care,” “[m]ental health and substance abuse disorder services, including behavioral health treatment,” “[p]rescription drugs,” “[r]ehabilitative and habilitative services and devices,” “[l]aboratory services,” “[p]reventive and wellness services and chronic disease management,” and “[p]ediatric services, including oral and vision care.”⁵⁴

Under the ACA, all health insurance plans must now contain significant minimum health benefits. Insurance plans can no longer provide exclusions for certain kinds of care, such as mental health or substance abuse.⁵⁵ This means that insurers cannot unilaterally exclude these benefits, but it also means that individuals seeking lower-cost health plans cannot purchase plans that exclude these benefits. As one critic of the ACA pointed out, it also means that “[i]nsurers must provide benefits that their insureds do not need (such as coverage for pregnancy for men)”⁵⁶ The result is essentially less choice in the health insurance marketplace.

Through its regulation of the health insurance product, the ACA has drastically increased the minimum coverage a health insurer must offer. Under the ACA’s regulations, neither individuals nor health insurers may decrease coverage amounts or benefits in an effort to reduce premiums.⁵⁷

3. Deciding How to Allocate Resources

Finally, in its most dramatic regulation of health insurance companies, the ACA sets a minimum “Medical Loss Ratio.”⁵⁸ The Medical Loss Ratio (MLR) as defined by the ACA is the ratio of: (1) the combined total of the amount of premium revenue spent on reimbursement for medical expenses provided to insured individuals and activities that “improve health care quality”⁵⁹ to (2) the total amount of premiums collected, excluding Federal and State taxes and other minor fees.⁶⁰ The stated purpose of the minimum MLR is to “ensure adequate participation by health insurance issuers, competition in the health insurance market . . . , and value for consumers so that premiums are used for clinical services and quality improvements.”⁶¹

⁵² *Id.* § 2704(a), 124 Stat. at 154.

⁵³ *Id.* § 2707, 124 Stat. at 161.

⁵⁴ *Id.* § 1302(b)(1)(A)–(J), 124 Stat. at 163–64.

⁵⁵ See *supra* notes 43–48 and accompanying text.

⁵⁶ Kopps, *supra* note 37, at 610.

⁵⁷ *Id.*; see § 1302(b)(1)(A)–(J), 124 Stat. 119, at 163–64.

⁵⁸ § 2718, 124 Stat. at 136–37, *amended by* § 10101, 124 Stat. at 885–87.

⁵⁹ *Id.* § 10101, 124 Stat. at 885.

⁶⁰ *Id.* § 10101, 124 Stat. at 886.

⁶¹ *Id.* § 10101, 124 Stat. at 887.

Under the ACA, the MLR is set at 85% for large group business and 80% for small group business.⁶² States have the power to set the MLRs higher than the federal minimum,⁶³ and the Secretary has the ability to adjust the percentage in each state if the Secretary believes that the application of the federal standards will “destabilize the individual market” in the state.⁶⁴ Once the MLR for a state is set, whether at the federal minimum or a state-specific ratio, if a company’s MLR is lower than what is required—meaning that the company spends less than the approved percentage of its premium dollars on paying claims and quality healthcare improvements—the company must issue a rebate to its insureds for the difference.⁶⁵ The effect of the rebate is to bring the MLR back to the level required by reducing the amount of premium revenue.

The MLR is a complicated principle that merits explanation by example. A health insurer receives \$1,000 in premium revenues for one year and provides only small group or individual coverage—no large group coverage. Under the federal standard, (omitting, for simplicity, any payment of taxes and fees) the insurer will be required to spend a minimum of \$800 in reimbursement for medical expenses and “activities that improve health care quality.”⁶⁶ If the health insurer fails to meet this minimum and only spends \$700 on those things, then the insurer will have to rebate \$100 to its enrollees. If the health insurer provides only large group coverage, it will be required to spend a minimum of \$850, and will have to return \$150 if it only spends \$700.

The effect of the MLR and its rebate requirement is that health insurance companies are now limited in the amount of revenue that can go towards administrative costs and profits on a yearly basis. Furthermore, because the MLR is calculated yearly, companies are not able to average their performance.⁶⁷ For example, a health insurer with only large group business that has an MLR of 90% (5% higher than the 85% required) one year, and an MLR of 80% the next (5% lower than required) will not be able to average the two years, but will have to pay their enrollees a 5% rebate in the second year. Critics of the plan point to this as one of its flaws—health insurance companies are not able to protect themselves for the “bad” years by having “good” years; each year is evaluated on a stand-alone basis.⁶⁸

Prior to the ACA’s passage, fifteen states had existing MLRs.⁶⁹ The state MLRs were defined differently,⁷⁰ and all of them were lower than the minimums set by the

⁶² *Id.* § 10101, 124 Stat. at 886.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* § 10101, 124 Stat. at 886–87.

⁶⁶ *Id.* § 10101, 124 Stat. at 885.

⁶⁷ See Kopps, *supra* note 37, at 611.

⁶⁸ See *id.* (“By not allowing insurance companies to keep extra profit in ‘good years’ to offset deficits in ‘bad years,’ [the ACA] is essentially forcing insurance companies into bankruptcy.”).

⁶⁹ *Medical Loss Ratios for Health Insurance*, NAT’L CONF. ST. LEGISLATORS, <http://www.ncsl.org/research/health/health-insurance-medical-loss-ratios.aspx> [<http://perma.cc/5UAK-8ZU23>] [hereinafter *Medical Loss Ratios for Health Insurance*].

⁷⁰ See Epstein & Stannard, *supra* note 16, at 261; see also Stubblebine, *supra* note 37, at 377.

ACA.⁷¹ Although state MLR ratios were lower than the ratio set by the ACA (the lowest existing state MLR was North Dakota's at 55 percent in the individual market),⁷² the way the ACA calculates its MLR is more favorable to health insurance companies. State MLRs were generally a straight ratio of claims paid out versus premiums received.⁷³ The ACA's MLR includes accounting for quality healthcare improvements and fees for taxes, licensing, and regulatory issues.⁷⁴ Perhaps because of the more lenient ratios, or because they only existed in several states, there have been no published challenges to the constitutionality of state MLRs.⁷⁵

The federal MLR went into effect in 2011, and insurers have issued rebates twice since then.⁷⁶ In 2012, insurers rebated over \$504 million to over 8.5 million Americans.⁷⁷ In 2013, that number had decreased to \$332 million to 6.8 million Americans.⁷⁸ The Department of Health and Human Services announced that the law is causing more health insurance companies to enter the market, creating greater competition.⁷⁹ So far, there have been no constitutional challenges to the federal MLR or reports of it forcing insurers out of business.⁸⁰

II. EXISTING SCHOLARSHIP

A. Why the Constitutionality of the MLR Is an Important Question

A lively, and sometimes nasty, discussion about the ACA's constitutional and statutory validity has been on going since before the legislation passed. This discussion has centered on the constitutionality of the Act's Individual Mandate,⁸¹ Medicaid

⁷¹ *Medical Loss Ratios for Health Insurance*, *supra* note 69.

⁷² *Id.*

⁷³ See *Explaining Health Care Reform: Medical Loss Ratio (MLR)*, KAISER FAM. FOUND. (Feb. 29, 2012), <http://www.kff.org/health-reform/fact-sheet/explaining-health-care-reform-medical-loss-ratio-mlr/> [<http://perma.cc/5DQ9-N6XG>].

⁷⁴ See *supra* notes 58–66 and accompanying text.

⁷⁵ This is based on the Author's research, including comprehensive searches of Westlaw and Lexis.

⁷⁶ See *2013 MLR Refunds by State*, CTR. FOR MEDICARE & MEDICAID SERVS., http://www.cms.gov/CCIIO/Resources/Data-Resources/Downloads/2013_MLR_Refunds_by_State.pdf [<http://perma.cc/N9WE-2NSE>]; *2012 Total Rebates*, CTR. FOR MEDICARE & MEDICAID SERVS., <http://www.cms.gov/CCIIO/Resources/Data-Resources/Downloads/2012-mlr-rebates-by-state-and-market.pdf> [<http://perma.cc/B4UA-XNJE>].

⁷⁷ *2012 Total Rebates*, *supra* note 76.

⁷⁸ *2013 MLR Refunds by State*, *supra* note 76.

⁷⁹ See Robert Pear, *Health Law is Fostering Competition, U.S. Says*, N.Y. TIMES (May 30, 2013), <http://www.nytimes.com/2013/05/31/health/health-law-is-fostering-competition-administration-says.html?hp&r=0> [<http://perma.cc/YP46-8AMK>].

⁸⁰ This is based on the Author's research.

⁸¹ See, e.g., *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

expansion,⁸² birth control requirement,⁸³ and most recently, a system of subsidies.⁸⁴ Much of this discussion focuses on how the ACA interferes with individual and states' rights.

The insurance industry is the single entity that will be the most effected by the ACA, yet there has been relatively little discussion of the effect the ACA will have on that industry. Additionally, there have been no legal challenges to the ACA based on the effect it will have on the business of insurance. This is, however, an incredibly important topic. The ACA depends on the insurance industry—the *private* insurance industry—for its successful implementation. It regulates the industry heavily.⁸⁵ Because of the important role the insurance industry plays in the ACA, it is important to evaluate the ACA's regulation of that industry.

Congress was not blind to the effect the ACA would have on the insurance industry. It was aware of the risk that limits on underwriting and increases in benefits would result in people staying out of the health insurance market until they needed coverage, thereby increasing the cost of health insurance for individuals who maintained coverage and further incentivizing individuals to abstain from purchasing health insurance.⁸⁶ The individual mandate was designed to minimize the risk of adverse selection and enable the health insurers to maintain a broad risk pool that could support the amount of claims the companies would be paying.⁸⁷

[I]f there were no [individual mandate], many individuals would wait to purchase health insurance until they needed care. By significantly increasing health insurance coverage, the [individual mandate], together with other provisions of this Act, will minimize this adverse selection and broaden the health insurance risk pool to include healthy individuals, which will lower health insurance premiums. *The requirement is essential to creating effective health insurance markets* in which improved health insurance products that are guaranteed issue and do not exclude coverage of pre-existing conditions can be sold.⁸⁸

Although the ACA sought to balance the competing interests of the individual, the states, and the health insurer, it remains controversial. Given the political climate,

⁸² See, e.g., *id.*

⁸³ See, e.g., *Burwell v. Hobby Lobby*, 134 S. Ct. 2751 (2014).

⁸⁴ See, e.g., Jess Bravin & Louise Radnofsky, *Supreme Court to Hear Case on Health-Care Law Subsidies*, WALL ST. J. (Nov. 8, 2014, 7:48 PM), <http://www.wsj.com/articles/supreme-court-to-hear-case-on-health-law-subsidies-1415383458> [<http://perma.cc/Q5B7-4DDV>].

⁸⁵ See *supra* Part I.

⁸⁶ See generally Epstein & Stannard, *supra* note 16, at 254.

⁸⁷ See ACA, Pub. L. No. 111-148, § 1501, 124 Stat. 119, 243 (2010).

⁸⁸ *Id.* (emphasis added).

constitutional challenges to the ACA are not going to stop. House opponents of the ACA have led fifty-four votes to overturn, defund, or limit the law.⁸⁹ Challenges to every conceivable aspect of the law continue to filter through the courts.⁹⁰ Critics of the law are clearly seeking to derail it in whatever way they can and will leave no stone unturned.⁹¹ The constitutionality of the MLR will likely be challenged at some point in the future.

B. Current State of the Discussion

The formidable Richard Epstein began the discussion of the MLR as an unconstitutional taking in an article about the Reid Bill, a precursor to the ACA.⁹² The Reid Bill included a more stringent MLR than the ACA—90% across the board, rather than the ACA's 85% and 80%.⁹³ Epstein later wrote an article with practitioner Paula Stannard attacking the ACA's MLR on similar grounds.⁹⁴ Epstein still leads the conversation, joined mainly by law students.⁹⁵ Because the current scholarly debate centers around Epstein's initial challenge, however, it carries the shortcomings of that initial argument.

The essence of Epstein and Stannard's argument is this—through its extensive regulations, the ACA converts the health insurance companies into de facto public utilities.⁹⁶ As such, the analysis that should be used to examine the constitutionality of any rate-making in the legislation is the public utility rate-making analysis.⁹⁷ Moreover, because the health insurance companies existed pre-ACA in a competitive market, any rate regulation is unnecessary because they already operate at the most efficient level possible.⁹⁸ Imposing more stringent rate requirements on health insurers will result in a reduction in services and quality, if not bankrupt the companies entirely.⁹⁹

⁸⁹ O'Keefe, *supra* note 27.

⁹⁰ *See id.*; *see also* Bravin & Radnofsky, *supra* note 84.

⁹¹ *See* O'Keefe, *supra* note 27.

⁹² Epstein, *supra* note 15.

⁹³ *See id.* at 1–2.

⁹⁴ *See id.*; *see also* Epstein & Stannard, *supra* note 16.

⁹⁵ *See supra* Epstein, note 15; *see also* Epstein & Stannard, *supra* note 16; Kopps, *supra* note 37; Stubblebine, *supra* note 37; Wesley D. Markham, *Healthcare Reform's Mandatory Medical Loss Ratio: Constitutionality, Policy, and Implementation*, 46 U. S.F. L. REV. 139 (2011).

⁹⁶ *See* Epstein & Stannard, *supra* note 16, at 263 (“Indeed, there is only one feature of the standard public utility that is not present: protection of constitutional rates of return.”).

⁹⁷ *Id.* at 262–63.

⁹⁸ *Id.* at 263.

⁹⁹ *Id.* at 264 (“To be clear, the justification for the MLRs cannot be that firms do not minimize administrative costs in order to maximize profits. They are doing that right now with their current allocation of services, so that the additional limits on administrative costs mean that certain important services, such as fraud prevention, are necessarily curtailed because of the want of the needed resources to combat them.”).

This argument has several major shortcomings. First, its conclusion that the ACA effectively converts health insurance companies into public utilities is incorrect. Because this conclusion is flawed, Epstein and Stannard apply the incorrect constitutional analysis to the MLR and draw conclusions about its constitutionality that are not merited. As discussed more fully below, legislative rate-making of public utilities merits a unique constitutional analysis because of the public utility's status as a *monopoly*.¹⁰⁰ Absent the monopoly status and the accompanying inability of the market to inform rate-making regulation, there is no good reason to apply anything other than the standard applied to ordinary regulation of companies.

Additionally, Epstein and Stannard fail to consider the impact the MLR has on the health insurers in light of the ACA *as a whole*. Pre-ACA, health insurers “ha[d] the conventional incentive to maximize their profits, which in the standard scenario means that they will only engage in certain expenditures to the point where the extra dollar that is paid out brings an extra dollar in.”¹⁰¹ They argue that this means that any additional regulation of the health insurance industry is unnecessary and ineffective, at best.¹⁰² “If these provisions made sense, they would be in the policies or plans already. But since they generally are not in all policies, we have to assume that each of them is in some sense an economic loser.”¹⁰³

Aside from the circularity of this argument—if the provisions made sense, they would be there; because they are not there, they do not make sense—even if it is true of parts of the ACA individually, the argument fails when considered in light of the ACA as a whole. The ACA is a comprehensive overhaul of the healthcare system.¹⁰⁴ It includes provisions regulating all aspects of the healthcare industry.¹⁰⁵ Even if the health insurance market had been functioning as best as possible before the ACA and competition among health insurers had led companies to adopt the most efficient business practices so as to maximize their profits, the ACA completely changed the market. The MLR was not introduced as a lone piece of legislation into a perfectly functioning market. A discussion of the effect the MLR will have on the health insurance companies can only be informative when done in light of the ACA *as a whole*.¹⁰⁶

Additionally, in stating that the health insurance industry existed in a competitive market that resulted in the highest levels of efficiency possible, Epstein and Stannard failed to take into account the extensive system of state regulation in which insurance companies have operated for decades.¹⁰⁷ States have not only regulated the

¹⁰⁰ See *infra* notes 266–69 and accompanying text.

¹⁰¹ Epstein & Stannard, *supra* note 16, at 264.

¹⁰² *Id.*

¹⁰³ *Id.* at 265.

¹⁰⁴ See Harrington, *supra* note 30.

¹⁰⁵ See *supra* Part I.

¹⁰⁶ See *infra* notes 119–24 and accompanying text.

¹⁰⁷ See, e.g., 1 BERTRAM HARNETT & IRVING I. LESNICK, THE LAW OF LIFE AND HEALTH

policies insurance companies can sell¹⁰⁸ and imposed minimum medical loss ratios on insurance companies,¹⁰⁹ but they have regulated the rates companies can charge¹¹⁰ and the ways in which companies can underwrite.¹¹¹ Epstein and Stannard's conclusion that insurance companies do not need regulation because they have been operating just fine without it is just factually inaccurate.

Finally, their argument that insurance companies do not need regulation because they have "the conventional incentive to maximize their profits"¹¹² does not take into account the effect on the consumer. In making this statement, they seem to be assuming that consumers have perfect (or at least very good) information and would not pay a lower price for a product that is not as good because the consumer would know that the product is not as good. However, insurance practices and policies are extremely complicated, and many people who have insurance do not understand their policies.¹¹³ In a recent study, a healthcare economist gave 202 people who had employer-sponsored health insurance a multiple-choice quiz testing their understanding of four basic health insurance terms.¹¹⁴ A shocking 14% of participants got all four answers correct.¹¹⁵ Clearly, healthcare consumers do not have the amount of knowledge and information required to ensure that the system works effectively and that health insurance

INSURANCE § 1.02 ("The business of insurance, its companies, its products, and its people are heavily regulated, especially in those states with large urban and commercial concentrations.").

¹⁰⁸ See, e.g., *id.* § 1.02(3)(b) ("Almost all states, in one way or another, have requirements for the official filing or approval of insurance policy forms. Under the most strict regulatory pattern, a policy must be filed, and it is not usable until approved.").

¹⁰⁹ See *supra* notes 62–65 and accompanying text.

¹¹⁰ See, e.g., HARNETT & LESNICK, *supra* note 107, at § 1.02(3) ("In certain cases [the role of state regulation] also includes fairness of rates and equality of insuring opportunities. While state regulation to some extent limits what insurers can do, under what is known as 'the filed rate rule' or 'filed rate doctrine,' regulatory approval of rates and policy forms can protect insurers from attempts to judicially enforce statutory requirements of reasonability.").

¹¹¹ See, e.g., *id.* § 3.01(7) ("Legislative limitations on risk selection in life and health insurance are familiar, but, until recently, have been of limited scope. Traditionally, these limitations have been motivated by considerations of fairness—as in the long standing [sic] prohibition in some states on racially discriminatory underwriting—and social policy, as in limitations on underwriting based on . . . blindness, exposure to DES and sexual orientation. . . . In the 1990s however, such legislative limitations on underwriting have undergone an explosive growth.").

¹¹² Epstein & Stannard, *supra* note 16, at 264.

¹¹³ See, e.g., Sarah Kliff, *Do You Understand Health Insurance? Most People Don't.*, WASH. POST: WONKBLOG (Aug. 8, 2013), <http://www.washingtonpost.com/news/wonkblog/wp/2013/08/08/do-you-understand-health-insurance-most-people-dont/> [<http://perma.cc/ESF3-9LPR>] (quoting a healthcare economist: "I have a PhD in economics and I've spent a bunch of time giving insurance companies feedback about policies, and I still find them difficult to understand").

¹¹⁴ George Loewenstein et al., *Consumers' Misunderstanding of Health Insurance*, 32 J. HEALTH ECON. 850, 853 (2013). The quiz tested subjects' understanding of: (1) out-of-pocket maximum; (2) coinsurance; (3) co-pay; and (4) deductible. *Id.*

¹¹⁵ *Id.* at 855.

companies are not only maximizing profits but are giving consumers the best value for their dollar. This is one of the major goals of the MLR.¹¹⁶

Subsequent discussions of the MLR's constitutionality have many of the same shortcomings as Epstein's and Stannard's analysis.¹¹⁷ To some extent, each incorrectly applies the public utility rate-making analysis to examine the MLR as a taking, fails to fully develop the constitutional analysis, and fails to examine the effect the MLR will have on the insurance industry in light of the ACA *as a whole*.

The fundamental shortcoming in the existing scholarly work on the MLR is that it uses the wrong constitutional standard to analyze the constitutionality of the provision. As discussed below, the proper constitutional standard is the regulatory takings analysis governed by *Penn Central*.¹¹⁸ Under this standard, the MLR does not rise to the level of a taking in violation of the Fifth Amendment.

III. CONSTITUTIONAL ISSUES

The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed 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.¹¹⁹

Although the MLR is not as widely criticized as other aspects of the ACA, it has been subject to increasing scrutiny on constitutional grounds.¹²⁰ The recent criticism is that the MLR "deprive[s] firms of a sensible rate of return"¹²¹ and thus "rises to the level of an unconstitutional taking of property under the Fifth Amendment."¹²² This argument inappropriately applies the public utility rate-making analysis to insurance companies.

The appropriate standard for a constitutional challenge of the MLR as a violation of the Takings Clause of the Fifth Amendment is the analysis applied in regulatory takings of private property. This standard is commonly referred to as the *Penn Central*¹²³ test and involves weighing a regulation's economic impact, its interference with reasonable investment-backed expectations, and the character of the governmental action.¹²⁴

¹¹⁶ See ACA, Pub. L. No. 111-148, § 2718, 124 Stat. 119, 136-37 (2010), *amended by* § 10101, 124 Stat. 119, 886 (2010). The section setting forth the minimum medical loss ratios is entitled "Ensuring that Consumers Receive Value for Their Premium Payments." *Id.*

¹¹⁷ See Kopps, *supra* note 37; Markham, *supra* note 95.

¹¹⁸ See *infra* Part III.B.1.

¹¹⁹ *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

¹²⁰ See, e.g., Epstein & Stannard, *supra* note 16; Kopps, *supra* note 37.

¹²¹ Epstein & Stannard, *supra* note 16, at 264.

¹²² Kopps, *supra* note 37, at 608.

¹²³ *Penn Central*, 438 U.S. 104 (1978).

¹²⁴ *Id.* at 124.

This Part outlines the two different constitutional analyses. It argues that the analysis applied in the public utilities context is not appropriate for the MLR because public utilities' unique status as monopolies justifies the use of a distinct constitutional analysis. Health insurance companies are neither monopolies nor public utilities, thus the *Penn Central* regulatory takings analysis should be applied to determine if the MLR is an unconstitutional taking.

A. Public Utility Rate-Making Analysis

There is an established body of federal law analyzing the constitutionality of government rate regulation in the context of public utilities. Generally, rate regulation is unconstitutional "if the government sets the utility's charges . . . at a level that is judicially determined to be unjust and confiscatory."¹²⁵ Thus, public utility rate regulations do not constitute a taking of property *unless* the rate of return is so low that it is considered "confiscatory."¹²⁶ The body of federal law examining rate regulation as a taking of property is largely concerned with defining "confiscatory."¹²⁷

The modern standard governing the issue of unconstitutionally confiscatory rate-making by a public utility is largely governed by *Duquesne Light Co. v. Barasch*.¹²⁸ In *Duquesne*, the Duquesne Light Company challenged a Pennsylvania law prohibiting electric utilities from including in their rates the cost of construction of a facility until that facility was being used "in service to the public."¹²⁹ Duquesne sought to increase its rates in order to amortize in excess of \$34 million it had spent in the construction of nuclear power plants after abandoning the project.¹³⁰ The Court ruled that utility rate regulation does not constitute a taking of property when the company is still allowed a "reasonable rate of return on equity given the risks."¹³¹

The main thrust of the decision in *Duquesne* was that rate regulation of public utilities only becomes unconstitutional when the rate becomes "unjust" or "unreasonable," and when it fails to give investors "a fair rate of return given the risks."¹³²

No argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability

¹²⁵ RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW § 15.12(b)(viii), at 1010–11 (5th ed. 2012).

¹²⁶ *Id.*

¹²⁷ *Id.* at 1011.

¹²⁸ 488 U.S. 299 (1989).

¹²⁹ *Id.* at 302.

¹³⁰ *Id.* The Court and the Pennsylvania Public Utility Commission determined that Duquesne "could not be faulted for initiating the construction" and that the investment was, at the time it was made, prudent. *Id.* at 302–03.

¹³¹ *Id.* at 315.

¹³² *Id.* at 310.

to raise future capital. Nor has it been demonstrated that these rates are inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme.¹³³

The standard for constitutional analysis outlined in *Duquesne* is a result-oriented one.¹³⁴ Regardless of the methodology or the reasoning behind the rate-setting system, rates will not be considered unconstitutional unless the *result* of the rate is to deprive the utility of a “fair rate of return given the risks.”¹³⁵

While *Duquesne* established that there is no constitutionally mandated methodology for setting rates so long as the rates do not end up being unjust or unreasonable, other Supreme Court decisions have established constitutionally *permitted* methods for setting rates. The early standard for rate-setting was known as the “fair value” rule.¹³⁶ The fair value standard balanced the company’s right to “a fair return upon the value of that which it employs for the public convenience” with the public’s right to pay no more “than the services rendered by [the utility] are reasonably worth.”¹³⁷

The fair value standard involved setting rates at the level they *would* be if the utility were operating within the competitive market.¹³⁸ The utility retains some of the risk of their investment failing because if the facilities or services never turn out to be useful to the public (and thus employ nothing for the public convenience), the investments do not justify exacting any return from the public.¹³⁹ However, if the investment is a good one, and the services are used by the public, the utility is entitled to a “fair return” on that investment.¹⁴⁰

While good in theory, the fair value standard proved difficult in practice.¹⁴¹ One of the main problems was “the laborious and baffling task of finding the present value of the utility.”¹⁴² Finding the fair market value of a commodity that, by definition, existed outside of a fair market consistently presented difficulties for the Court.¹⁴³ Under the fair value rule, the Court admitted that at times, its calculations were “speculative.”¹⁴⁴

¹³³ *Id.* at 312.

¹³⁴ *Id.* at 310.

¹³⁵ *Id.*

¹³⁶ *Id.* at 308.

¹³⁷ *Smyth v. Ames*, 169 U.S. 466, 547 (1898).

¹³⁸ *Duquesne*, 488 U.S. at 308.

¹³⁹ *Smyth*, 169 U.S. at 547.

¹⁴⁰ *Id.*; *see also Duquesne*, 488 U.S. at 308–09.

¹⁴¹ *Duquesne*, 488 U.S. at 309; *see also Missouri ex rel. Sw. Bell Tel. Co. v. Pub. Serv. Comm’n*, 262 U.S. 276, 292–94 (1923) [hereinafter *Southwestern Bell*] (Brandeis, J., concurring).

¹⁴² *Southwestern Bell*, 262 U.S. at 292 (Brandeis, J., concurring).

¹⁴³ *See id.* at 292–94.

¹⁴⁴ *Louisville v. Cumberland Tel. & Tel. Co.*, 225 U.S. 430, 436 (1914).

After decrying the fair value rule as too difficult to implement, Justice Brandeis proposed an alternative method for evaluating public utility rates.¹⁴⁵ Brandeis concluded that the “taking” in public utility regulation was not the taking of the physical property or the facilities, but the capital that was invested in the enterprise.¹⁴⁶ Thus, the appropriate method for setting rates is to ensure that the utility is compensated for all prudent investments at the actual cost of the investments when made, whether or not they turn out to be of use to the public.¹⁴⁷ Because the utilities carry less of the risk, they are limited to a standard rate of return, but their return is based on *all* money prudently invested, not just money that ends up being used for services for the public good.¹⁴⁸

The Court adopted this method as a constitutionally permissible one in *Federal Power Commission v. Hope Natural Gas Co.*¹⁴⁹ In *Hope*, the Court held that “historical cost” (the cost of a utility’s prudent investments in its operations) were a valid way of calculating compensation.¹⁵⁰ “Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called ‘fair value’ rate base.”¹⁵¹ The Court declined to find the rates unconstitutional based solely on the theory from which they were calculated, and emphasized that the *result* is what makes a rate constitutional or not.¹⁵² “[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry . . . is at an end.”¹⁵³

The Supreme Court has consistently reaffirmed that, in analyzing the constitutionality of public utility rates, what matters is the *resulting rate*, not the methodology or theory that led to the rate.¹⁵⁴ Moreover, a rate only violates the Constitution if it is so unjust as to be confiscatory.¹⁵⁵

There is a common thread running through the rate-making doctrine that strains the constitutional analysis when it is applied outside the context of a public utility. A public utility is “[a] company that provides necessary services to the public, such

¹⁴⁵ *Southwestern Bell*, 262 U.S. at 290–91 (Brandeis, J., concurring).

¹⁴⁶ *Id.* at 291.

¹⁴⁷ *Id.* at 302–10.

¹⁴⁸ *Id.*

¹⁴⁹ 320 U.S. 591 (1944).

¹⁵⁰ *Id.* at 605.

¹⁵¹ *Id.*

¹⁵² *Id.* at 602.

¹⁵³ *Id.*

¹⁵⁴ See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308–09 (1989); *Southwestern Bell*, 262 U.S. 276, 292–94 (1923).

¹⁵⁵ See, e.g., *Fed. Power Comm’n v. Texaco, Inc.*, 417 U.S. 380, 391–92 (1974) (“All that is protected against, in the constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level.”).

as telephone lines and service, electricity, and water. Most utilities operate as monopolies but are subject to governmental regulation.”¹⁵⁶ In *Duquesne*, the Court clarified an element of the “reasonable rate” calculation.¹⁵⁷ “The risks a utility faces are in large part defined by the rate methodology because utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks.”¹⁵⁸ If the “risk” part of the “fair rate of return given the risks” standard is concerned solely—or even almost solely—with risks regarding regulation itself, then that standard is inapplicable outside the public utility context. A company that operates in a highly competitive industry—like the health insurance industry—faces completely different risks than one that operates as a protected monopoly. Therefore, a constitutional analysis that is designed to take into account risks specific to a public utility cannot appropriately be applied to a company that faces a different set of risks.¹⁵⁹

Moreover, the constitutional analysis the Court applies in the public utility rate-making context evolved from a standard designed to set rates at what they *would* be if the utility operated within a competitive market.¹⁶⁰ This, too, is inapplicable outside the public utility context. When a company is operating within a competitive market, the market functions to set the rates at a competitive level.¹⁶¹ Because the rate-making context is completely different, the constitutional analysis should be as well.

B. Regulatory Takings Analysis

The paradigmatic taking is when the government enters a person’s private property and appropriates the property for government use.¹⁶² Because a regulatory taking will never look exactly like the paradigmatic taking, the purpose of the regulatory taking analysis is to identify situations that are comparable to a direct ouster or appropriation.¹⁶³ Thus, the focus of the analysis is on the burden imposed on the private property.¹⁶⁴

Two kinds of regulatory takings constitute per se takings: (1) when the government allows a permanent physical occupation of property, and (2) when a regulation completely deprives an owner of all economically beneficial uses of her property.¹⁶⁵

¹⁵⁶ *Public Utility*, BLACK’S LAW DICTIONARY (10th ed. 2014).

¹⁵⁷ *Duquesne*, 488 U.S. at 314–15.

¹⁵⁸ *Id.* at 315.

¹⁵⁹ The differences between public utilities and health insurance companies are more fully discussed *infra* Part IV.A.

¹⁶⁰ See *supra* notes 136–48 and accompanying text.

¹⁶¹ See Epstein & Stannard, *supra* note 16, at 262.

¹⁶² *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 537 (2005).

¹⁶³ *Id.* at 542.

¹⁶⁴ *Id.* at 543.

¹⁶⁵ *Id.* at 538.

Aside from those narrow and very rarely occurring circumstances,¹⁶⁶ the inquiry is based on the *Penn Central* analysis and is ad hoc and fact-intensive.¹⁶⁷ The party attempting to establish a taking bears a heavy burden of proof, and courts generally defer to the regulation.¹⁶⁸

1. *Penn Central* Analysis

Aside from the two narrow per se takings exceptions, regulatory takings are analyzed based on the *Penn Central* standard.¹⁶⁹ The *Penn Central* analysis “is characterized by essentially ad hoc, factual inquiries designed to allow careful examination and weighing of all the relevant circumstances.”¹⁷⁰

Penn Central involved a challenge by Penn Central Transportation Company, the owners of New York City’s Grand Central Terminal, to New York City’s Landmarks Preservation Law.¹⁷¹ Penn Central sought to lease the air rights above the terminal to a company that would construct a fifty-five-story office building.¹⁷² The terminal had been designated a landmark under the Landmarks Preservation Law, and when Penn Central applied for permission to construct the addition, permission was denied.¹⁷³ Penn Central then filed suit, claiming that the application of the Landmarks Law unconstitutionally deprived them of their property without just compensation.¹⁷⁴

The Court held that the prohibition did not constitute an unconstitutional taking of property under the Fifth Amendment.¹⁷⁵ The Court assessed the “severity of the impact of the law on [Penn Central’s] parcel,”¹⁷⁶ and concluded that the law did not interfere with Penn Central’s primary expectation concerning the use of its land because they could “continue to use the property precisely as it had been used for the

¹⁶⁶ These circumstances are both incredibly rare and not applicable to the MLR; thus, although part of the regulatory takings doctrine, they will not be discussed or examined at length.

¹⁶⁷ *Lingle*, 544 U.S. at 538–39; see also *E. Enters. v. Apfel*, 524 U.S. 498, 522–23 (1998).

¹⁶⁸ See, e.g., *Penn Central*, 438 U.S. 104 (1978); *Lingle*, 544 U.S. at 528; *Concrete Pipe & Prods. v. Constr. Laborers Pension Tr.*, 508 U.S. 602 (1993).

¹⁶⁹ *Lingle*, 544 U.S. at 538–39.

¹⁷⁰ *Tahoe-Sierra Pres. Council v. Tahoe Reg’l Planning Agency*, 535 U.S. 302, 322 (2002) (citations omitted).

¹⁷¹ 438 U.S. at 107.

¹⁷² *Id.* at 116.

¹⁷³ *Id.* at 116–18.

¹⁷⁴ *Id.* at 119. The lease agreement that Penn Central had negotiated involved payment of \$1 million annually during construction of the addition and a minimum of \$3 million annually thereafter. *Id.* at 116. This was in 1968. *Id.* Adjusted for only inflation—not taking into account the rising property values in New York City—the amount of money that the prohibition on construction cost Penn Central annually was \$6,802,758.62 and \$20,408,275.86, respectively. CPI INFLATION CALCULATOR, U.S. BUREAU LAB. STAT., <http://data.bls.gov/cgi-bin/cpicalc.pl?cost1=3%2C000%2C000.00&year1=1968&year2=2014> [<http://perma.cc/TU7A-MZF7>] (input “1,000,000” or “3,000,000” for “\$” and “1968” for “in”).

¹⁷⁵ *Penn Central*, 438 U.S. at 138.

¹⁷⁶ *Id.* at 136.

past 65 years.”¹⁷⁷ Additionally, the Court held that Penn Central had not shown that the law effectively abrogated its rights to use the airspace above the terminal because “nothing the Commission has said or done suggests an intention to prohibit *any* construction above the Terminal.”¹⁷⁸ Further, Penn Central had not been denied *all* use of the air rights because Penn Central could transfer the rights, and although that transfer might not constitute “‘just compensation’ if a ‘taking’ had occurred, the rights nevertheless undoubtedly mitigate whatever financial burdens the law has imposed.”¹⁷⁹ Because “[t]he restrictions imposed are substantially related to the promotion of the general welfare and not only permit reasonable beneficial use of the landmark site but also afford appellants opportunities further to enhance not only the Terminal site proper but also other properties,” the regulation did not constitute a taking of property.¹⁸⁰

The *Penn Central* analysis begins with the assertion that the Fifth Amendment is “designed 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.”¹⁸¹ The Court acknowledges the absence of a “set formula” for evaluating when “justice and fairness” require that a taking be found, but goes on to identify “several factors that have particular significance” in the inquiry.¹⁸² These have come to be known as the “*Penn Central* factors.”¹⁸³ These factors are: (1) the economic impact of the regulation on the claimant; (2) the regulation’s interference with the claimant’s distinct, investment-backed expectations; and (3) the character of the governmental action.¹⁸⁴

The three prongs of the *Penn Central* test all need to be considered, and no one of them is dispositive.¹⁸⁵ The claimant must prove that the economic impact of the regulation is severe, that the regulation interferes substantially with the claimant’s distinct investment-backed expectations, and that the character of the governmental action is similar to that of a paradigmatic taking.¹⁸⁶ Because the Court has articulated that the goal of a regulatory takings analysis is to identify regulations that are functionally equivalent to the paradigmatic taking in which the government appropriates private property for its own purpose,¹⁸⁷ in evaluating each of these factors, the focus is on “the severity of the burden that government imposes on private property rights.”¹⁸⁸

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 137.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at 138.

¹⁸¹ *Id.* at 123 (quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960)).

¹⁸² *Id.* at 124.

¹⁸³ *See, e.g., Tahoe-Sierra Pres. Council v. Tahoe Reg’l Planning Agency*, 535 U.S. 302, 320 (2002).

¹⁸⁴ *Penn Central*, 438 U.S. at 124.

¹⁸⁵ *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 538–39 (2005).

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* at 539.

¹⁸⁸ *Id.*

If, when considered as a whole, the combined impact of all three prongs makes the governmental action look like the paradigmatic taking, then the Court will find a taking.¹⁸⁹

a. The Economic Impact of the Regulation

The first prong of the *Penn Central* analysis focuses on the “economic impact of the regulation on the claimant.”¹⁹⁰ The Court further defines this analysis as “the nature and extent of the interference with rights in the parcel as a whole.”¹⁹¹ The focus is on the “parcel as a whole,” rather than on specific parts of an owner’s property that are effected by a regulation.¹⁹² This precludes a claimant from defining his property right narrowly so that the economic impact appears to be larger than it is.¹⁹³

Another consequence of focusing on the parcel as a whole in the regulatory takings analysis is that it carries with it an implicit requirement that the claimant must establish a *property interest* in order to establish a taking.¹⁹⁴ Thus, regardless of the extent to which a regulation economically impacts a claimant, if the regulation does not interfere with a “legitimate property interest[],”¹⁹⁵ it is not a taking for Fifth Amendment purposes.¹⁹⁶ The “legitimate property interest” requirement of the *Penn Central* analysis will be discussed in more detail later.¹⁹⁷

¹⁸⁹ *Id.* at 539–40.

¹⁹⁰ *Id.* at 538 (citations omitted).

¹⁹¹ *Penn Central*, 438 U.S. 104, 130–31 (1978). *See also* Stephen J. Eagle, “Economic Impact” in *Regulatory Takings Law*, 19 HASTINGS W.-NW. J. ENVTL. L. & POL’Y 407, 413–14 (2013).

¹⁹² *Penn Central*, 438 U.S. at 130–31.

¹⁹³ Eagle, *supra* note 191, at 413–14; *see also Penn Central*, 438 U.S. at 130–31 (holding that a regulation’s economic impact must be examined for its effect on the “parcel as a whole,” not discrete segments thereof).

¹⁹⁴ *See* Eagle, *supra* note 191, at 415 (explaining that the Federal Circuit applies the *Penn Central* analysis in two steps: (1) determining whether the claimant has established a property interest, and (2) determining whether the governmental action at issue amounted to a taking of that property interest).

¹⁹⁵ *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 540 (2002).

¹⁹⁶ *See E. Enters. v. Apfel*, 524 U.S. 498, 543–44 (1998) (Kennedy, J., concurring in the judgment and dissenting in part) (“[The regulation] neither targets a specific property interest nor depends upon any particular property for the operation of its statutory mechanisms. The liability imposed on Eastern no doubt will reduce its net worth and its total value, but this can be said of any law which has an adverse economic effect. . . . [T]he Government’s imposition of an obligation between private parties, or destruction of an existing obligation, must relate to a specific property interest to implicate the Takings Clause.”); *id.* at 554 (Breyer, J., dissenting) (“This case involves not an interest in physical or intellectual property, but an ordinary liability to pay money, and not to the Government, but to third parties. This Court has not directly held that the Takings Clause applies to the creation of this kind of liability.”); *see also United States v. Willow River Co.*, 324 U.S. 499, 502 (1945) (“[N]ot all economic interests are ‘property rights’; only those economic advantages are ‘rights’ which have the law back of them, and only when they are so recognized may courts compel others to forbear from interfering with them or to compensate for their invasion.”).

¹⁹⁷ *See infra* notes 271–76 and accompanying text.

The *Penn Central* Court put forth several general standards for evaluating the economic impact of a regulation.¹⁹⁸ The analysis involves determining whether the regulation has “an unduly harsh impact upon the owner’s use of the property,”¹⁹⁹ whether the claimant can obtain “a ‘reasonable return’ on its investment,”²⁰⁰ and whether the property remains “economically viable.”²⁰¹

The promulgation of so many different standards to use in evaluating just one prong of the Court’s test highlights the lack of bright line rules and the incredibly fact-specific nature of the inquiry. In applying these nebulous standards, the Court is highly deferential to government regulation.²⁰² In order to establish an economic impact so severe that it constitutes a taking, a claimant must essentially show a complete deprivation of economic interest.²⁰³ “[M]ere diminution in the value of property, however serious, is insufficient to demonstrate a taking.”²⁰⁴

b. The Interference with Reasonable Investment-Backed Expectations

Since its first regulatory takings analysis after *Penn Central*, the Court has treated the interference with reasonable investment-backed expectations as the second prong of the *Penn Central* analysis.²⁰⁵ There is, however, a body of scholarship that asserts that *Penn Central* itself combined this prong with the first prong and only put forth a two-prong test.²⁰⁶ Moreover, that scholarship points out the shift in language from *Penn Central*’s “distinct investment-backed expectations”²⁰⁷ to “reasonable investment backed expectations.”²⁰⁸ Regardless of which interpretation is true to the *Penn Central* Court’s original intent, the Court now consistently applies the “interference with reasonable investment backed expectation[]” as the second prong of the *Penn Central* analysis.²⁰⁹

¹⁹⁸ *Lingle*, 544 U.S. at 539.

¹⁹⁹ *Penn Central*, 438 U.S. 104, 127 (1978).

²⁰⁰ *Id.* at 136.

²⁰¹ *Id.* at 138 n.36.

²⁰² See *Concrete Pipe & Prods. v. Constr. Laborers Pension Tr.*, 508 U.S. 602, 645 (1993).

²⁰³ See *id.* (citing cases in which no taking was found when there was a 75% diminution in value, *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384 (1926), or a 92.5% diminution in value, *Hadacheck v. Sebastian*, 239 U.S. 294, 405 (1915)).

²⁰⁴ *Id.*

²⁰⁵ *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979).

²⁰⁶ See, e.g., *Eagle*, *supra* note 191, at 415 & n.49.

²⁰⁷ *Penn Central*, 438 U.S. 104, 124 (1978) (emphasis added).

²⁰⁸ *Kaiser Aetna*, 444 U.S. at 175 (emphasis added); see, e.g., *Eagle*, *supra* note 191, at 433–34.

²⁰⁹ See, e.g., *E. Enters. v. Apfel*, 524 U.S. 498, 523 (1998); *Concrete Pipe & Prods. v. Constr. Laborers Pension Tr.*, 508 U.S. 602, 645 (1993); *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 212 (1986).

Interpreting this prong as an extension of the first prong, however, does help to explain some of the Court's analytical behavior. In discussing a regulation's economic impact (the first prong), the Court often discusses the extent to which the impact is proportional to the claimant's past experiences with previous legislation.²¹⁰ Proportional impact, however, seems like it would be a more appropriate analysis under the second prong of the test. Additionally, much of the analysis of the second prong is similar to the analysis under the first prong.²¹¹

One distinct difference in the analysis, however, is that under the second prong, the Court focuses more on what the claimant reasonably expected as it relates to regulations.²¹² This prong of the analysis focuses on whether an unanticipated change in regulations would "erode economic viability of the investment in the whole property after imposition."²¹³

The focus on *reasonable*—rather than *distinct*—investment-backed expectations "had the effect of converting landowners' informed judgments about future possibilities into a reasonable notice of rules inquiry."²¹⁴ Thus, under the second prong, the focus is on whether a claimant would reasonably expect that she would be faced with the burden imposed by the regulation.²¹⁵ In evaluating whether a claimant would reasonably expect the burden imposed by the regulation, past regulation, although not dispositive, is a major factor.²¹⁶

The second prong of the *Penn Central* test has evolved into what is essentially an inquiry into reasonable notice of future regulation.²¹⁷ The Court is very reluctant to find interference in this area when a claimant has previously been subjected to extensive regulation of the same kind.²¹⁸ However, even when a claimant has been

²¹⁰ See *E. Enters.*, 524 U.S. at 530; *Concrete Pipe & Prods.*, 508 U.S. at 645; *Connolly*, 475 U.S. at 224.

²¹¹ See, e.g., *E. Enters.*, 524 U.S. at 532 ("For similar reasons [to the reasons for economic impact], the Coal Act substantially interferes with Eastern's reasonable investment-backed expectations.").

²¹² See, e.g., *id.* at 532–36 (holding that the retroactivity of the regulation at issue raised "substantial questions of fairness" because it deprived the claimant of its expectations and imposed an unexpected burden on the claimant).

²¹³ William W. Wade, *Sources of Regulatory Takings Economics Confusion Subsequent to Penn Central*, 41 ENVTL. L. REP. NEWS & ANALYSIS 10,936, 10,938 (2011).

²¹⁴ Eagle, *supra* note 191, at 433 (citing Wade, *supra* note 213, at 10,938).

²¹⁵ See *E. Enters.*, 524 U.S. at 536 ("Nor would the pattern of the Federal Government's involvement in the coal industry have given Eastern 'sufficient notice' that [liability would be imposed]."); *Concrete Pipe & Prods.*, 508 U.S. at 646 ("[I]t could have had no reasonable expectation that it would not be faced with liability for promised benefits."); *Connolly*, 475 U.S. at 227 ("Prudent employers then had more than sufficient notice not only that pension plans were currently regulated, but also that withdrawal itself might trigger additional financial obligations.").

²¹⁶ See, e.g., *Connolly*, 475 U.S. at 227.

²¹⁷ See, e.g., *Concrete Pipe & Prods.*, 508 U.S. at 645–47.

²¹⁸ See, e.g., *id.*

subject to prior regulation, if the regulation at issue is significantly different from past regulation, the Court will find that it interferes with the claimant's expectations.²¹⁹

c. The Character of the Governmental Action

The final prong of the *Penn Central* test is in some ways the most straightforward. The Court clarified the nature of this inquiry: "A 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good."²²⁰ Thus, the inquiry into the character of the governmental action can be described as an inquiry into how similar the governmental action is to the paradigmatic taking in which the government enters private property and appropriates it for its own use.

Penn Central recognized several classes of cases in which the character of the governmental action would *not* constitute a taking for Fifth Amendment purposes: when the regulation promotes public "health, safety, morals, or general welfare;"²²¹ when the regulation makes "a choice between the preservation of one class of property and that of the other;"²²² when the regulation concludes that a specific use of property is "inconsistent with neighboring uses;"²²³ and when the regulation "substantially furthers important public policies."²²⁴ However, when regulations are merely "acquisitions of resources to permit or facilitate uniquely public functions,"²²⁵ the character of the governmental action often can constitute a taking.

In applying this prong, the Court has stayed relatively true to its original analysis. It has refused to find a taking under this prong when the regulation merely adjusted economic benefits and burdens to promote the common good.²²⁶ The Court further explained a limitation on challenges to Government regulation:

In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others. . . . Given the propriety of the governmental power to regulate, it cannot be said that the Takings Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.²²⁷

²¹⁹ See, e.g., *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992) ("Retroactive legislation presents problems of unfairness . . . because it can deprive citizens of legitimate expectations and upset settled transactions.").

²²⁰ *Penn Central*, 438 U.S. 104, 124 (1978) (citations omitted).

²²¹ *Id.* at 125.

²²² *Id.* at 126.

²²³ *Id.*

²²⁴ *Id.* at 127.

²²⁵ *Id.* at 128.

²²⁶ *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 225 (1986).

²²⁷ *Id.* at 223.

The final prong of the *Penn Central* analysis remains essentially focused on determining how similar the governmental action is to the paradigmatic taking.

Unless a claimant can prove that a regulation constitutes a permanent physical occupation of her property or that it deprives her of all economically beneficial uses of her property, both of which are extraordinary circumstances, then a regulatory takings claim will be analyzed under the *Penn Central* framework. An ad hoc and fact-intensive inquiry, the *Penn Central* analysis examines the economic impact on the claimant, the interference with the claimant's reasonable investment-backed expectations, and the character of the governmental action to determine if the regulation constitutes a taking of the claimant's property. The purpose of this analysis is to identify situations that are similar to a government ouster or appropriation, but a regulation that simply adjusts the burdens and benefits of economic life will rarely constitute a regulatory taking.

IV. TAKINGS ANALYSIS APPLIED TO THE MLR

A. The Public Utilities Takings Analysis Should Not Be Applied to the MLR

A public utility is a company that (1) provides a necessary public service; (2) is subject to extensive government regulation; and (3) operates as a monopoly.²²⁸ More specifically, a public utility is: "a vertically integrated company, government-selected, providing prescribed services within a defined territory at approved prices."²²⁹ Further, public utilities are supported by a "legal infrastructure, called a franchise."²³⁰ The legal infrastructure has seven distinct dimensions, all of which are designed to align the utility's interest with the public interest.²³¹ This Note will discuss four of these seven dimensions: (1) exclusive retail franchise (monopoly power described as the "right to be the sole provider of a government-prescribed service within a state-defined service territory"),²³² (2) obligation to serve; (3) consent to regulation; and (4) quality of service.²³³

1. Exclusive Retail Franchise

Public utilities almost always have monopoly status that is granted and maintained by statute. Although the extent of a utility's monopoly power varies based on the

²²⁸ *Public Utility*, BLACK'S LAW DICTIONARY (10th ed. 2014).

²²⁹ SCOTT HEMPLING, REGULATING PUBLIC UTILITY PERFORMANCE: THE LAW OF MARKET STRUCTURE, PRICING AND JURISDICTION 14 (2013).

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

²³³ *Id.* at 14–15. Only the four dimensions that apply to health insurance companies will be discussed in this Note.

statute, when states grant exclusive franchises to public utilities, they prohibit competition within a specific geographic area, and appoint a company to be the *sole provider of services* in that area.²³⁴

In contrast, health insurance companies operate in a highly competitive market. With health insurance companies, “[t]here are no territorial or product monopolies. There is cut-throat competition among large and sophisticated suppliers who deal with sophisticated employers who know that if they do not supply decent coverage to their employees, they risk the loss of their services.”²³⁵ Further, a goal of the ACA is to bring more health insurance companies into the market to increase competition, thereby increasing quality and service.²³⁶ This is also a goal of the MLR specifically—to “incentivize insurance companies to reduce administrative costs and premiums.”²³⁷ Lower premiums lead to more competition among health insurers because price ceases to be as much a factor in determining which company to use, and companies thus have to compete more in the areas of customer service and product quality.

A justification commonly given for the protected monopoly status of public utilities is economic efficiency.²³⁸ Many public utilities are “natural monopolies.” A natural monopoly is a function of “the relationship between demand and the technology of supply. If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it.”²³⁹ Additionally, the nature of the product and services public utilities provide lends itself to monopoly status. The Supreme Court noted that allowing competition among public utility companies could result in disruptions in the daily life of society:

[B]y the time natural gas became a widely marketable commodity, the States had learned from chastening experience that public streets could not be continually torn up to lay competitors’ pipes, that investments in parallel delivery systems for different fractions of a local market would limit the value to consumers of any price competition, and that competition would simply give over to monopoly in due course. It seemed virtually an economic necessity for States to provide a single, local franchise with a business opportunity free of competition from any source, within or without the State, so long as the creation of exclusive franchises under state

²³⁴ HEMPLING, *supra* note 229, at 15.

²³⁵ Epstein & Stannard, *supra* note 16, at 262.

²³⁶ Stubblebine, *supra* note 37, at 361, 376.

²³⁷ *Id.*

²³⁸ See generally Richard A. Posner, *Natural Monopoly & Its Regulation*, 21 STAN. L. REV. 548 (1969).

²³⁹ *Id.* at 548.

law could be balanced by regulation and the imposition of obligations to the consuming public upon the franchised retailers.²⁴⁰

None of these considerations apply to health insurance companies. While it is possible that one health insurance company could meet the needs of the entire market at the lowest cost, the fact that so many health insurance companies are in the market suggests that a single, monopoly provider would either not meet the needs of the market adequately or do so at the lowest cost.²⁴¹ Additionally, establishing new health insurance companies does not require that “public streets . . . be continually torn up,”²⁴² or that individuals’ daily lives be otherwise disrupted. A health insurance company enters the market just like any other business does—by renting or buying office space, hiring personnel, filing the necessary paperwork, and jumping through the required regulatory hoops.²⁴³ Health insurance companies are neither natural monopolies nor the sorts of companies for which monopoly protection is beneficial to the public.

2. Obligation to Serve

As a condition of the monopoly power that many states grant public utilities, they also often give them an “obligation to serve,” meaning that public utilities must take all comers.²⁴⁴

Virginia’s statute is clear on the requirement of obligation to serve: “It shall be the duty of every public utility to furnish reasonably adequate service and facilities at reasonable and just rates to any person, firm or corporation along its lines desiring same.”²⁴⁵ The statute also expressly states that utilities may not discriminate in the rates they charge: “It shall be the duty of every public utility to charge uniformly therefor all persons, corporations or municipal corporations using such service under like conditions.”²⁴⁶

This characteristic of public utilities arguably applies to health insurance companies under the ACA. By prohibiting health insurance companies from denying coverage

²⁴⁰ *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 289–90 (1997).

²⁴¹ As of 2013, there were 359,907 direct health insurance carriers in the country. *State Insurance Regulation: Key Facts and Market Trends*, NAT’L ASS’N INS. COMM’RS (Aug. 19, 2014), http://www.naic.org/state_report_cards/report_card_wa.pdf [<http://perma.cc/9LTY-ZGDE>]. That number rose from 331,547 in 2011, an increase of 28,360 companies, or almost 8% of the existing market. *Id.*

²⁴² *Gen. Motors Corp.*, 519 U.S. at 290.

²⁴³ *See, e.g.*, Kay Miranda, *How to Start an Independent Insurance Company*, HOUSTON CHRON., <http://smallbusiness.chron.com/start-independent-insurance-company-2306.html> [<http://perma.cc/PCA3-5RG3>] (discussing the steps to establish a new insurance company).

²⁴⁴ HEMPLING, *supra* note 229, at 14.

²⁴⁵ VA. CODE ANN. § 56-234 (2011).

²⁴⁶ *Id.*

to individuals,²⁴⁷ the ACA essentially requires that the companies take all comers. Similarly, by severely limiting the amount of underwriting health insurance companies can do,²⁴⁸ the ACA essentially requires that the companies charge a (somewhat) uniform price to every person. However, this characteristic of public utilities alone does not justify the use of a separate constitutional takings analysis. It is all the qualities of public utilities taken together that grants them a unique position in the market and unique constitutional protection.

3. Consent to Regulation

When public utilities accept the grant of exclusive retail franchise and the obligation to serve, they also consent to existing and subsequent regulation.²⁴⁹ This principle is over one hundred years old and began with *Munn v. Illinois*.²⁵⁰ In *Munn*, owners of grain elevators and warehouses challenged an Illinois statute that capped the prices they could charge, claiming that the profit cap was an unconstitutional taking of their property.²⁵¹ The Supreme Court rejected that argument in part because the businesses were involved in an enterprise which affected the public²⁵²:

When . . . one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. . . . [S]o long as he maintains the use, he must submit to the control.²⁵³

Even though the statute capped the prices the grain elevators and warehouses could charge—and thus their profits—the Court did not find it unconstitutional because the businesses had essentially consented to regulation by engaging in a business that affected the public interest.²⁵⁴

This attribute of public utilities—that they are engaged in a business that affects the public interest—also arguably applies to health insurance companies. The ACA was enacted in part because of the virtual necessity of wide access to health insurance coverage.²⁵⁵ Further, even if health insurance companies did *not* provide a

²⁴⁷ See *supra* notes 45–47 and accompanying text (discussing the factors insurance companies may consider).

²⁴⁸ See *supra* notes 41–51 and accompanying text.

²⁴⁹ See HEMPLING, *supra* note 229, at 15.

²⁵⁰ 94 U.S. 113 (1877).

²⁵¹ *Id.* at 123.

²⁵² *Id.* at 126.

²⁵³ *Id.*

²⁵⁴ *Id.*

²⁵⁵ See Stubblebine, *supra* note 37, at 343 (discussing the purposes of the ACA).

service that was necessary, their service certainly affects the public interest. Additionally, even if a distinction *did* exist between public and private companies that subjected the former but not the latter to regulation, the Supreme Court did away with that distinction in *Nebbia v. New York*,²⁵⁶ in which it held that *all* economic actors are subject to regulation.²⁵⁷ Because “there is no closed class or category of businesses affected with a public interest,”²⁵⁸ *Nebbia* established that it was no longer only public utilities that were subject to economic regulation.²⁵⁹ Moreover, “[t]he Constitution does not secure to anyone liberty to conduct his business in such fashion as to inflict injury upon the public at large, or upon any substantial group of the people.”²⁶⁰

Although this attribute of public utilities also applies to the health insurance industry, *Nebbia* established that it applies to *all* businesses because all businesses in some ways affect the public interest.²⁶¹ Thus, the presence of this characteristic in the health insurance industry does not justify applying the constitutional analysis that has been developed for public utilities.

4. Quality of Service

Public utilities are subject to regulation requiring them to maintain a certain quality of service. Legislatures have recognized that the grant of an exclusive retail franchise might distort incentives for public utilities.²⁶² Public utilities have no competition, rates that are set by statute, and statutorily guaranteed rates of return. Thus, there is little inherent incentive for public utilities to maintain a quality product or service. Therefore, many legislatures regulate the quality of service that a public utility must provide.²⁶³ The New York statute provides that the Commission may order public utilities to make “such reasonable improvements as will best promote the public interest, preserve the public health and protect those using” the utility’s services.²⁶⁴

This aspect of public utilities does not apply to health insurance companies. Although the ACA requires health insurance companies to make certain information public about their quality and performance,²⁶⁵ it does not grant the government any power to order them to make changes in the service or product they provide. If an

²⁵⁶ 291 U.S. 502 (1934).

²⁵⁷ *Id.* at 531.

²⁵⁸ *Id.* at 536.

²⁵⁹ *Id.*

²⁶⁰ *Id.* at 538–39.

²⁶¹ *Id.* at 536.

²⁶² HEMPLING, *supra* note 229, at 44–45.

²⁶³ *Id.*

²⁶⁴ N.Y. PUB. SERV. LAW § 66(2) (2013).

²⁶⁵ ACA, Pub. L. No. 111-148, § 2718, 124 Stat. 119, 136–37 (2010), *amended by* § 10101, 124 Stat. 119, 885–87 (2010) (requiring health insurance companies to report their yearly MLRs so consumers will be able to evaluate the efficiency of each health insurance company).

insurance company continually provides poor quality service, the intense competition in the market will correct that problem—consumers will stop purchasing the product, and the health insurance company will either go out of business or improve the quality of its product. Because health insurance companies do not have monopoly status, there is no need for the legislature to require that they comply with a specific level of quality of service—the market can be trusted to correct any deficiencies in quality.

Although public utilities have many unique attributes, it is mainly their monopoly status that makes it reasonable to apply a separate constitutional analysis to rate-making in that context. Public utilities, as monopolies, essentially operate outside the free market.²⁶⁶ This means that there is no way to really know what the optimal rates are in monopolies because the lack of competition eliminates the “delicate balancing act whereby [the firm] must ask whether the additional services that it could supply will generate revenues equal to, or greater than, its costs of providing those services.”²⁶⁷ Because this balancing does not naturally occur, the only way to set prices while ensuring that the service remains is by reference to profit. This is why the public utility analysis is focused on ensuring that the company recovers a “fair rate of return given the risks.”²⁶⁸

Health insurance companies, however, operate in a highly competitive market. There is no need to define rates with reference to profits because the marketplace defines which rates are reasonable and which are not. Because the reasons behind the separate constitutional analysis for public utilities are not present in the context of the ACA, it should be examined under the general regulatory takings doctrine governed by *Penn Central*.²⁶⁹

B. Under the Penn Central Analysis, the MLR Does Not Constitute a Taking

Under the *Penn Central* analysis, the MLR does not constitute a taking of property in violation of the Fifth Amendment. In order to establish a taking, a health

²⁶⁶ See 54A AM. JUR. 2D MONOPOLIES, RESTRAINTS OF TRADE, AND UNFAIR TRADE PRACTICES § 770, at 80 (2009) (“[A] monopoly is the practical suppression of effective business competition which thereby creates a power to control prices to the public harm.”); see also *Monopoly*, BLACK’S LAW DICTIONARY (10th ed. 2014) (“The market condition existing when only one economic entity produces a particular product or provides a particular service.”).

²⁶⁷ Epstein, *supra* note 15, at 15.

²⁶⁸ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

²⁶⁹ The assertion that challenges to the insurance company regulation side of the ACA should be analyzed under the *Penn Central* standard is further supported by a recent decision in the United States District Court for the District of Columbia. In *American Council of Life Insurers v. D.C. Health Benefits Exchange Authority*, 2014 U.S. Dist. LEXIS 160038 (D.D.C. 2014), the district court ruled on a challenge that the D.C. Health Benefit Exchange Authority unconstitutionally took private property when it assessed a fee on insurance companies doing business in the District. “The Supreme Court’s evaluation of a takings claim predicated on the allegation, similar to the plaintiff’s here, that a regulation imposes an excessive or unfair burden is evaluated under the *Penn Central* factors.” *Id.* at *69–70.

insurance company would have to show a recognizable property interest and that the MLR severely impacted the economic interests of the company and interfered with its distinct, investment-backed expectations. Further, it would have to show that the character of the government action approximated a direct appropriation or ouster.²⁷⁰

1. Profits as Property

A threshold matter for the health insurer to overcome is whether or not it can establish a property right in its profits.²⁷¹ In order to make an effective Takings Clause challenge, the health insurer will have to establish an interest “sufficiently bound up with [its] reasonable expectations . . . to constitute ‘property’ for Fifth Amendment purposes.”²⁷²

The Supreme Court has recently engaged in spirited debate about what is sufficient to constitute a property interest that implicates the Takings Clause.²⁷³ Generally, the Court refuses to find an identifiable property interest for Takings Clause purposes when a claimant is simply required to pay money—whether to the Government or to third parties.²⁷⁴

Arguably, requiring the health insurance companies to pay money to a third party is exactly what the MLR does.²⁷⁵ Part of the argument that the MLR affects an unconstitutional taking is predicated on the requirement that health insurers issue rebates to policyholders when their MLR falls below the required minimum.²⁷⁶ Indeed, the MLR cannot be examined as a taking apart from the rebate requirement. If the ACA simply required that health insurers operate with an MLR of a specified

²⁷⁰ See *supra* notes 220–27 and accompanying text.

²⁷¹ See, e.g., *E. Enters. v. Apfel*, 544 U.S. 498, 544 (1998) (Kennedy, J., concurring) (“[T]he Government’s imposition of an obligation . . . must relate to a specific property interest to implicate the Takings Clause.”); *Penn Central*, 438 U.S. 104, 124–25 (1978) (“[T]his Court has dismissed ‘taking’ challenges on the ground that, while the challenged government action caused economic harm, it did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute ‘property’ for Fifth Amendment purposes.”).

²⁷² *Penn Central*, 438 U.S. at 125.

²⁷³ See *Koontz v. St. Johns River Water Mgmt. Dist.*, 133 S. Ct. 2586, 2603–04 (2013) (Kagan, J., dissenting) (“[The majority] . . . runs roughshod over *Eastern Enterprises v. Apfel*, which held that *the government may impose ordinary financial obligations without triggering the Takings Clause’s protections.*”) (emphasis added) (citations omitted); see also *E. Enters.*, 524 U.S. at 498 (holding, by plurality, that a regulation requiring claimant to pay money to a third party violated the Takings Clause; however, five justices held that the Takings Clause did not apply because there was no identifiable property interest).

²⁷⁴ See *supra* note 196.

²⁷⁵ See *supra* notes 51–57 and accompanying text.

²⁷⁶ See *Epstein & Stannard*, *supra* note 16, at 261 (“[I]t is easy to envision scenarios in which the MLR provision may preclude insurance companies from earning any return on their investment. It is even possible to envision scenarios in which insurance companies may be required to pay rebates while operating at a loss.”).

percentage (and no corresponding penalty for not doing so), there would be no effect on health insurers that operated at an MLR below the minimum. There could be no taking because there would be no effect on the business.

Given the decision in *Eastern Enterprises*, however, the Court would likely consider the profits of the health insurance company a recognizable property interest.²⁷⁷ If the Court declines to find a recognizable property interest, then the inquiry is over and the MLR survives a constitutional challenge. If, however, the Court finds a property interest, then it would move on to the *Penn Central* analysis.

2. Facial Challenge

A second threshold matter is that a facial challenge to the MLR would certainly fail. For a facial challenge to succeed, it would mean that “the statute produces an unconstitutional outcome, in all states of the world, for the parties in question.”²⁷⁸ In the context of a regulatory takings analysis, the health insurance company would have to show that the MLR results in one of the per se takings: that it is either a permanent physical occupation of the company’s property, or that it results in a complete deprivation of all economically beneficial uses of the company’s property.²⁷⁹

There is no situation in which the MLR could be considered a permanent physical occupation of property. Although the size of the physical occupation is irrelevant for the analysis,²⁸⁰ any challenge to the MLR would be based on the effect that the regulation has on profits. There is no tenable argument that the MLR effects a physical appropriation. The only way a health insurer could hope to succeed in challenging the MLR as a violation of the Fifth Amendment’s Taking Clause would be under the *Penn Central* analysis.

3. *Penn Central* Analysis

Because the *Penn Central* analysis is ad hoc and fact-intensive, a health insurance company could only bring a successful takings challenge *after* it has been negatively affected by the operation of the MLR.²⁸¹ The Court would then consider the MLR’s “‘character’ and ‘economic impact’, asking whether [it] goes beyond ‘adjusting the benefits and burdens of economic life to promote the common good’ and whether it ‘interferes with distinct investment-backed expectations.’”²⁸²

²⁷⁷ See 524 U.S. at 498; see also *supra* note 273.

²⁷⁸ Epstein & Stannard, *supra* note 16, at 244.

²⁷⁹ See *supra* notes 166–69 and accompanying text.

²⁸⁰ See *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

²⁸¹ See *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 540 (2005) (discussing how the *Penn Central* question largely rests on impacts on, and interference with, the property interest). In order for a court to evaluate the severity of the regulation’s economic impact, there must have been an economic impact; thus, an insurance company could not challenge the MLR unless and until it has been adversely economically affected. *Id.*

²⁸² *Koontz v. St. Johns River Water Mgmt. Dist.*, 133 S. Ct. 2586, 2604 (2013).

a. Economic Impact

In order to establish that an economic impact is sufficiently burdensome to effect a taking, a health insurer would have to prove a considerable economic impact. The Supreme Court has declined to find a taking when property's value was diminished by 75%,²⁸³ when property's value was diminished by 92.5%,²⁸⁴ or when a claimant was required to pay out 46% of its shareholder equity.²⁸⁵ Further, the Supreme Court has upheld laws against takings claims even when the regulations prohibited the continued operation of a previously lawful business.²⁸⁶

Additionally, the *Penn Central* analysis examines the "parcel as a whole."²⁸⁷ "Taking" jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated."²⁸⁸ Thus, a court would examine the impact of the MLR on the *entirety* of the company, not just its impact over a particular period of time, in a particular state, or on a particular area of the health insurer's business.²⁸⁹ In this way, the larger the health insurance company is, the less likely it is that it could prove an economic impact sufficient to establish a taking. If the company had other areas of business that were not adversely affected by the MLR, it would be less likely that the Court would consider that the business bore an unreasonable economic burden because the company's property *as a whole* would not have been sufficiently adversely affected to constitute a taking.

Based on this high standard, it is unlikely that the Court would find that the economic impact of the MLR was so onerous as to effect a taking.

²⁸³ *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384 (1926).

²⁸⁴ *Hadacheck v. Sebastian*, 239 U.S. 394, 405 (1915).

²⁸⁵ *Concrete Pipe & Prods. v. Constr. Laborers Pension Tr.*, 508 U.S. 602, 645 (1993).

²⁸⁶ *United States v. Cent. Eureka Mining Co.*, 357 U.S. 155 (1958) (closing gold mines so that workers would be available for other mining work); *Walls v. Midland Carbon Co.*, 254 U.S. 300 (1920) (prohibiting the continued manufacture of black carbon); *Hadacheck*, 239 U.S. at 394 (prohibiting the continued operation of claimant's brickyard); *Reinman v. Little Rock*, 237 U.S. 171 (1915) (prohibiting the continued operation of claimant's livery stable).

²⁸⁷ *Penn Central*, 438 U.S. 104, 130 n.27 (1978).

²⁸⁸ *Id.* at 130.

²⁸⁹ *See Tahoe-Sierra Pres. Council v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 330–31 (2002) ("Certainly, our holding that the permanent 'obliteration of the value' of a fee simple estate constitutes a categorical taking does not answer the question whether a regulation prohibiting any economic use of land for a 32-month period has the same legal effect. . . . Of course, defining the property interest taken in terms of the very regulation being challenged is circular."); *see also Concrete Pipe*, 508 U.S. at 644 ("To the extent that any portion of property is taken, that portion is always taken in its entirety; the relevant question, however, is whether the property taken is all, or only a portion of, the parcel in question.").

b. Interference with Reasonable Investment-Backed Expectations

In evaluating the MLR's interference with reasonable investment-backed expectations, the Court would focus on the extent to which health insurers had notice that they would be subject to regulation similar to the MLR.²⁹⁰

There are two reasons that this part of the test would likely fail to meet the standard for a taking. First, under any interpretation, health insurers have had significant notice that they would be subject to regulation similar to the MLR. Health insurance costs have been rising substantially over the last several decades.²⁹¹ Healthcare reform has been a topic of discussion for years, and a federal solution has been on the horizon at least since the Clinton health plan of 1993.²⁹² Additionally, many states have had individual MLRs in place for years, and some states have been slowly raising their MLRs in an effort to increase health insurance company efficiency.²⁹³

Second, the longer the MLR is in place, the more evidence there is that companies in a variety of states are able to meet the federal MLR.²⁹⁴ Some health insurers are able to operate at a level higher than the federal minimum MLR, indicated by the fact that they did not pay rebates.²⁹⁵ With information showing that companies are able to effectively conduct business and maintain profits while operating within the MLR, individual health insurers who are *not* able to do so would have a hard time proving that it is because of the MLR rather than their method of conducting business.

Because health insurers have had significant notice that they would be subject to regulation like the MLR, and because companies have been able to operate successfully under the MLR it is unlikely that the Court would find the MLR's interference with reasonable investment-backed expectations so onerous as to effect a taking.

c. Character of the Governmental Action

In evaluating the character of the government action in the MLR, the Court would focus on how similar the MLR is to a paradigmatic taking or a direct ouster.²⁹⁶ The character of the governmental action in the MLR would almost certainly cut against the Court finding that it constitutes a taking.

²⁹⁰ See *supra* notes 205–20 and accompanying text.

²⁹¹ See BAKER & LOGUE, *supra* note 38, at 231 (“Annual expenditures on health care in the United States are over \$2 trillion and rising.”).

²⁹² See generally Robert E. Moffit, *A Guide to the Clinton Health Plan*, HERITAGE FOUND. (Nov. 19, 1993), <http://www.heritage.org/research/reports/1993/11/a-guide-to-the-clinton-health-plan> [<http://perma.cc/4P8J-W2VG>].

²⁹³ See, e.g., *Medical Loss Ratios for Health Insurance: State Medical Loss Requirements*, NAT'L CONF. ST. LEGISLATURES, <http://www.ncsl.org/research/health/health-insurance-medical-loss-ratios.aspx#requirements> [<http://perma.cc/N4JN-4EVZ>].

²⁹⁴ See, e.g., *2013 MLR Refunds by State*, *supra* note 76.

²⁹⁵ See *id.*

²⁹⁶ See *supra* notes 220–27 and accompanying text.

The MLR is far from the paradigmatic taking or anything resembling physical appropriation of private property for a governmental purpose. It does not require that health insurers allow the government to use their property,²⁹⁷ and it does not require that health insurers allow third parties to use their property.²⁹⁸

The MLR, especially when taken in the context of the ACA as a whole, is much more like a public program that simply “adjust[s] the benefits and burdens of economic life to promote the common good.”²⁹⁹ A stated purpose of the MLR is to “ensure . . . value for consumers so that premiums are used for clinical services and quality improvements.”³⁰⁰ The MLR adjusts the burdens of economic life by focusing on value for health insurance consumers rather than profits and ease of operation for health insurance companies.³⁰¹

Additionally, the MLR is like other classes of regulations in which the Court has held that the character of the governmental action did not constitute a taking. The MLR promotes “general welfare”³⁰² by attempting to control premium prices.³⁰³ Especially with regulation requiring everyone to have health insurance, lower health insurance premiums contribute to the general welfare by freeing up more money to be spent in other ways. Finally, the MLR furthers the “important public polic[y]”³⁰⁴ of “ensur[ing] adequate participation by health insurance issuers, competition in the health insurance market . . . , and value for consumers so that premiums are used for clinical services and quality improvements.”³⁰⁵

Because the character of the governmental action in the MLR is far from the paradigmatic taking and the regulation is essentially one that adjusts the benefits and burdens of economic life, it is unlikely that the Court would find the character of the governmental action the kind which would amount to a taking.

Under the *Penn Central* analysis, it is not likely that a challenge to the MLR under the Takings Clause of the Fifth Amendment would succeed. If the Court considers the insurance company’s expectation of profits to constitute a property right, which it

²⁹⁷ See, e.g., *United States v. Gen. Motors Corp.*, 323 U.S. 373 (1945) (taking occurs when the government temporarily takes over a part of claimant’s leasehold).

²⁹⁸ See, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (taking occurs when the government requires claimant to allow third parties to occupy claimant’s property).

²⁹⁹ *Penn Central*, 438 U.S. 104, 124 (1978).

³⁰⁰ ACA, Pub. L. No. 111-148, § 2718, 124 Stat. 119, 136–37 (2010) amended by § 10101, 124 Stat. 119, 885–87 (2010).

³⁰¹ See *supra* notes 58–61 and accompanying text.

³⁰² *Penn Central*, U.S. 438 at 125.

³⁰³ Although the MLR does not directly address premium rates, the lower an insurance company’s administrative costs and expenses are, the lower its premiums will need to be to cover its expenses. In this way, the MLR controls premium prices by controlling administrative costs and overhead.

³⁰⁴ *Penn Central*, 438 U.S. at 127.

³⁰⁵ § 2718, 124 Stat. at 136–37, amended by § 10101, 124 Stat. at 885–87.

likely would, a challenge to the MLR would have to meet the high standards of the *Penn Central* ad hoc, fact-intensive balancing test. The MLR's economic impact and its interference with reasonable investment-backed expectations would likely not be sufficient for the Court to find a taking. Additionally, the character of the governmental action is very unlike that of the paradigmatic taking and very similar to regulations that merely adjust the benefits and burdens of economic life. The *Penn Central* standard is deferential to regulation, and claimants bear a substantial burden in proving a taking.³⁰⁶ It is unlikely that the MLR could bear that burden.

CONCLUSION

The constitutionality of the MLR is likely to be one of the next legal challenges to the ACA. Most of the scholarly work examining the constitutionality of the MLR to this point has applied the wrong constitutional analysis, resulting in the conclusion that the MLR effects an unconstitutional taking of private property. This Note attempts to rectify that error. It is not appropriate to apply the public utility rate-making analysis to the MLR because public utilities operate as monopolies. The focus of rate-making, and thus the constitutional analysis, in the public utility context is very different than it is in the highly competitive health insurance industry. This is why the Supreme Court has developed different constitutional standards to govern public utility rate-making and regulatory takings of private property.

The proper constitutional standard to analyze the MLR is the regulatory takings doctrine governed by the *Penn Central* analysis. Under *Penn Central*, the MLR will not be struck down as unconstitutional because it will not have an economic impact on health insurance companies sufficient to frustrate their reasonable investment-backed expectations. Moreover, the character of the governmental action is not similar to the paradigmatic taking in which the government appropriates private property for its own use. The MLR simply adjusts the benefits and burdens of economic life for the public good and is a constitutional regulation of health insurance companies.

³⁰⁶ 438 U.S. 104 (1978).