STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

March 18, 2014

Opinion No. 14-34

Constitutionality of Legislation Restricting Changes to Health Care Contracts

QUESTION

Does Senate Bill 2427/House Bill 2303 of the 108th General Assembly (2014) (hereinafter "SB2427") implicate Article I, § 20, of the Tennessee Constitution if a material change is made to an open-ended contract that has an indefinite initial term or no stipulated renewal date?

OPINION

No. Because Section 3 of SB2427 gives the bill only prospective application (i.e., forecloses its application to existing open-ended contracts), the bill does not implicate Article I, § 20, of the Tennessee Constitution.

ANALYSIS

SB2427 would amend the Tennessee Insurance Law by adding a new Part 34 to Chapter 7 of Title 56 that places restrictions upon a third-party payer[1] who wishes to effect a "material change" to a contract under which a health care provider is paid for services. A "material change" is defined as "a change in fees or payment methodologies that a reasonable person would attach in determining the action to be taken upon the change." SB2427, § 1. Included in the definition of "material change" is a "change to fee schedules, coding guidelines, edits, payment rules, . . . claim payment procedures, or any other elements that the third-party payer utilizes to determine payment of reimbursement amounts." *Id.*

The bill would restrict a third-party payer from making a material change to such a contract during the first year of the contract or the initial term of the contract, whichever is longer. After the initial term or first year of the contract, SB2427 would permit the third-party payer to make a material change only on the stipulated renewal date of the contract or the anniversary of the effective date of the contract, whichever is longer. If the third-party payer desires to make a material

[1] "Third-party payer" is defined as "a health insurer, third-party administrator, or other person that is obligated pursuant to health insurance coverage or a health benefits plan, to pay for covered health care services rendered to beneficiaries." SB2427, § 1.

change at that time, SB2427 would require the third-party payer to provide a calculation that estimates any reduction in the health care provider's cumulative allowed amount based on twelve months, or an annualized shorter look back period, of actual data. Under the bill, third-party payers and health care providers are prevented from waiving these provisions by contract, and "any such purported waiver is void." SB2427, § 1.

Article I, § 20, of the Tennessee Constitution states "that no retrospective law, or law impairing the obligations of contracts, shall be made." Similarly, Article I, § 10, of the United States Constitution provides that "[n]o state shall . . . pass any . . . law impairing the obligation of contracts." The Tennessee Supreme Court has observed that the meaning of these state and federal constitutional provisions is identical. *First Util. Dist. of Carter County v. Clark*, 834 S.W.2d 283, 287 (Tenn. 1992). Each of these provisions is referred to as the "Contract Clause."

The Contract Clause prohibits laws "which take away or impair vested rights acquired under existing laws or create a new obligation, impose a new duty, or attach a new disability in respect of transactions or considerations already passed." *Estate of Bell v. Shelby Cnty. Health Care Corp*., 318 S.W.3d 823, 829 (Tenn. 2010) (quoting *Morris v. Gross*, 572 S.W.2d 902, 907 (Tenn. 1978)). Among the main tests for determining whether the obligation of a contract has been impaired are whether the value of the contract or security has been lessened, *Lake County v. Morris*, 160 Tenn. 619, 28 S.W.2d 351, 354 (1930), and whether the right in full existing at the time the contract was executed has been diminished. *Hannum v. McInturf*, 65 Tenn. 225, 1873 WL 4006, at *2 (1873). Accordingly, the obligation of contract is impaired when a legislative enactment changes the obligation in favor of one party against another, either by enlarging or reducing the obligation. 16B Am. Jur. 2d *Constitutional Law* § 775 (2014).

SB2427 would restrict a third-party payer from making a material change to a contract under which a health-care provider is paid during the first year of the contract or the initial term of the contract, *whichever is longer*. Open-ended health-care contracts have indefinite initial terms. Therefore, if SB2427 were applied to an existing open-ended contract, the third-party payer would never be able to make a material change to the contract. The legislative change would thus deprive the third-party payer of one of its substantive rights under the contract and change the contract in favor of the health-care provider; consequently, SB2427 would impair the obligation of contracts between third-party payers and health-care providers.[2]

[2] The legislature may impair the obligation of contracts without violating the Contract Clause if such legislation is enacted in the exercise of the police power. *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 437 (1934); *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123, 28 S.W. 668, 674 (Tenn. 1894). The State's police power includes authority to protect the general welfare of the people, *Ford Motor Co. v. Pace*, 206 Tenn. 559, 335 S.W.2d 360, 370 (1960), and SB2427's stated purpose is to do just that. S.B. 2427, Preamble. But the Contract Clause demands that the exercise of this power "be upon reasonable conditions and of a character appropriate to the public purpose justifying its

But SB2427 expressly provides that it "shall apply to all policies, contracts, and health benefit plans *issued, delivered, or renewed* in the state on or after October 1, 2014." SB2427, §3 (emphasis added). Construing this provision to give SB2427 only prospective application (i.e., to foreclose its application to existing open-ended contracts),[3] the bill does not run afoul of Article I, § 20. It has been clear since 1827 that the Contract Clause applies only to laws with retrospective, not prospective, effect, *see Local Div. 589, Amalgamated Transit Union v. Massachusetts*, 666 F.2d 618, 637 (1st Cir. 1981) (citing *Ogden v. Saunders*, 6 L.Ed. 606 (1827)), and it is well settled that the legislature has power to declare the force and effect of future contracts made and to be executed in this State, *see West v. Jefferson Woolen Mills*, 147 Tenn. 100, 245 S.W. 542, 543 (Tenn. 1922); *Greenfield v. Dorris*, 33 Tenn. 548, 1853 WL 2315, at *3 (1853).

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adoption." *United States Trust Co. v. New Jersey*, 431 U.S. 1, 22 (1978); *see City of Paris v. Paris-Henry Cnty. Pub. Util. Dist.*, 207 Tenn. 388, 340 S.W.2d 885 (1960). If SB2427 were applied to an existing open-ended contract, the impairment would be substantial, as discussed above; such impairment would likely be seen as an unnecessary and unreasonable means by which to address general-welfare concerns and lead to the conclusion that SB2427 as so applied violates Article I, § 20.

[3]Statutes should be construed so as to avoid any unconstitutionality. *Freeman Indus., LLC v. Eastman Chemical Co.*, 172 S.W.3d 512, 521-22 (Tenn. 2005) (citing *Davis-Kidd Booksellers, Inc. v. McWherter*, 866 S.W.2d 520, 529 (Tenn. 1993)).