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Private Insurers Suspending Workers' Compensation Benefits Are Not State Actors and Employee's Medical Treatment Must Be Reasonable and Necessary before Due Process Attaches: *American Manufacturers Mutual Insurance Co. v. Sullivan*

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Private Insurers Suspending Workers' Compensation Benefits Are Not State Actors and Employee's Medical Treatment Must Be Reasonable and Necessary Before Due Process Attaches: *American Manufacturers Mutual Insurance Co. v. Sullivan*

DUE PROCESS — 42 U.S.C. § 1983 — STATE ACTION — The United States Supreme Court held that private workers' compensation insurers are not converted to state actors merely because the business is subject to extensive state regulation, and due process procedures are not implicated until the employee's property interest attaches by proving the medical treatment was reasonable and necessary.

American Manufacturers Mutual Insurance Co. v. Sullivan, 119 S. Ct. 977 (1999).

In an effort to control health care costs, Pennsylvania amended its Workers' Compensation Act ("Act")[1] in 1993 to permit an insurer to dispute the reasonableness or necessity of the medical treatment provided to an insured employee by requesting a "utilization review."[2] By requesting such a review, the insurer suspends payment of workers' compensation benefits to the health care

1. PA. STAT. ANN. tit. 77, §§ 1-2626 (West 1992 & Supp. 1998). "Pennsylvania's Workers' Compensation Act creates a system of no-fault liability for work-related injuries and makes employers' liability under this system 'exclusive . . . of any and all other liability.'" American Manufacturers Mut. Ins. Co. v. Sullivan, 119 S. Ct. 977, 982 (1999) (citing PA. STAT. ANN. tit. 77, § 481 (West 1992 & Supp. 1998)). "All employers subject to the Act must either (1) obtain workers' compensation insurance from a private insurer, (2) obtain such insurance through the State Workers' Insurance Fund (SWIF), or (3) seek permission from the state to self-insure." *Sullivan*, 119 S. Ct. at 982. (citing PA. STAT. ANN. tit. 77, § 501(a) (West 1992 & Supp. 1998)).

2. *Sullivan*, 119 S. Ct. at 982. Under Pennsylvania law, an employer who is liable for an employee's work-related injury must pay for all "reasonable and necessary" treatment. PA. STAT. ANN. tit. 77, §§ 531(1)(i), (5) (West 1992 & Supp. 1998). "Utilization review" is a procedure "under which the reasonableness and necessity of an employee's past, ongoing, or prospective medical treatment could be reviewed before a medical bill must be paid" by the insurance company. *Sullivan*, 119 S. Ct. at 982 (citing Pa. STAT. ANN. tit. 77, § 531(6) (West 1992 & Supp. 1998)). Before enacting the "utilization review" procedure, Pennsylvania did not provide an insurer with effective means of recovering payments for medical treatment that was later determined to be unreasonable or unnecessary. *Id.* at 982, n.2.

provider[3] until resolution of the dispute.[4] The insurer requests utilization review by filing a one-page form with the Workers' Compensation Bureau of the Pennsylvania Department of Labor and Industry ("Bureau"), which makes no attempt to validate the legitimacy of the request but only determines whether the form is properly completed.[5] The Bureau then informs the injured employee, the employer, and the health care provider that the claim is under review and "forwards the request to a randomly selected 'utilization review organization' ("URO")."[6] The URO then determines, based on medical records and statements by the health care provider and the injured employee, whether the treatment was reasonable and necessary.[7]

In 1996, ten injured employees and two labor organizations filed a 42 U.S.C § 1983[8] suit against private insurance companies and other defendants.[9] The plaintiffs' complaint alleged that by

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3. Pennsylvania defines "health care provider" as:

> A person, corporation, facility, or institution licensed, or otherwise authorized, by the Commonwealth to provide health care services, including physicians, coordinated care organizations, hospitals, health care facilities, dentists, nurses, optometrists, podiatrists, physical therapists, psychologists, chiropractors, or pharmacists, and officers, employees, or agents of the person acting in the course and scope of employment or agency related health care services.

34 PA. CODE § 127.3 (1998).

4. *Sullivan*, 119 S. Ct. at 983.

5. *See id.* "The form identifies (among other things) the employee, the medical provider, the date of the employee's injury, and the medical treatment to be reviewed." *Id.* (citing 34 PA. CODE §§ 127.404(b), 127.452(a) (1998)).

6. *Id.* at 983. "URO's are private organizations consisting of health care providers who are 'licensed in the same or similar profession . . . or specialty as that of the provider of the treatment under review.'" *Id.* at 983 (citing PA. STAT. ANN. tit. 77, § 531(6)(i) (West 1992 & Supp. 1998)). Any question as to the reasonableness and necessity of a given procedure must be resolved in favor of the medical provider, whose treatment is under review. 34 PA. CODE § 127.471(b) (1998). The provider, employer, employee, or insurer is given the opportunity to appeal; however, if the URO finds in favor of the insurer, the insurer need not pay for the disputed services unless the courts overrule the URO's holding. PA. STAT. ANN tit. 77, § 531(6)(iv) (West 1992 & Supp. 1998); 34 PA. CODE § 127.556 (1998). Conversely, if the URO rules on behalf of the employee, the insurer is then contiguously responsible for the challenged bill, plus 10 percent annual interest and the cost of the utilization review. *Sullivan*, 119 S. Ct. at 983; PA. STAT. ANN. tit. 77, § 531(6)(iii, iv) (West Supp.1998); 34 PA. CODE § 127.208(e) (1998).

7. *See* 34 PA. CODE § 127.470(a) (1998).

8. Federal statute 42 U.S.C. § 1983 provides in pertinent part: "Every person who, under color of any statute . . . , subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured . . . . " 42 U.S.C. § 1983 (1994).

9. *See Sullivan*, 119 S. Ct. at 983-84. The plaintiffs were individual employees and two organizations (the Philadelphia Area Project on Occupational Safety and Health and the

withholding workers' compensation benefits during the utilization review, the private insurance companies were acting under the color of state law and denying the employees' property rights without due process of law.[10]

The United States District Court for the Eastern District of Pennsylvania dismissed the complaint against the private insurers on the ground that they were not state actors.[11] The district court also dismissed the cause of action against the Commonwealth officials, reasoning that the procedure for withholding payment for disputed medical treatment, as defined in the Act, does not violate due process.[12]

On appeal, the United States Court of Appeals for the Third Circuit reversed and found that a private insurer's decision to suspend payment under the Act constitutes state action, because once an insurer, though a private entity, operates under the construct of the extensively state-regulated system of workers' compensation, it effectively becomes an arm of the state and fulfills the "uniquely governmental obligation" of providing or withholding state entitlements.[13] Concerning the due process issue, the Third Circuit did not address whether disabled employees possess a property interest in suspended workers' compensation benefits, but rather focused on what process is due.[14] The Third Circuit found that suspending insurance payments before employees have had the opportunity to submit a written personal statement to the URO regarding their view of the reasonableness and/or necessity of the disputed treatment violated due process.[15]

Philadelphia Federation of Teachers representing employees who received medical benefits under the Act). *Id.* at 983. "Named as defendants were various Pennsylvania officials who administer the Act, the director of State Workers Insurance Fund (SWIF), the School District of Philadelphia, and a number of private insurance companies who provide workers' compensation coverage in Pennsylvania." *Id.* at 984.

10. *See id.* at 984. The U.S. Constitution provides as follows: "[n]or shall any state deprive any person of life, liberty, or property, without due process of law . . . . " U.S. CONST. amend. XIV, § 1. Due process of law is defined as "a course of legal proceedings according to those rules and principles which have been established in our systems of jurisprudence for the enforcement and protection of private rights." BLACK'S LAW DICTIONARY 500 (6th ed. 1990).

11. *See Sullivan*, 119 S. Ct. at 984.

12. *See id.*

13. *See* Sullivan v. Barnett, 139 F.3d 158, 168 (1998).

14. *See Sullivan*, 139 F.3d at 171. The material part of Sullivan's complaint is that lack of notice afforded under the Act violates procedural due process guarantees. *Id.* The Third Circuit did not address the existence of property interests because "[n]either party disputes" this issue. *Id.* at 171 n.23.

15. *See id.* at 162. At the time of the Third Circuit decision, employees were not

The United States Supreme Court granted certiorari[16] to resolve two issues: (1) whether a private insurer's decision to withhold payment for disputed medical treatment constitutes state action under 42 U.S.C. §1983, and (2) whether "due process prohibits insurers from withholding payment for disputed medical treatment pending [utilization] review."[17]

Concerning the state action issue, the Court concluded that a private insurer's decision to withhold payment and seek utilization review of the reasonableness and necessity of particular medical treatments is not attributable to the state.[18] The Court emphasized that, to successfully claim relief in an action under 42 U.S.C. § 1983, the plaintiffs must prove that they were deprived of a constitutionally protected right and "that the alleged deprivation was committed under color of state law."[19]

In reaching its conclusion, the Court relied on a two-part analysis defined in *Lugar v. Edmondson Oil Co.*[20] The Court stated that to establish state action, the claimant must first prove that the "alleged constitutional deprivation [was] 'caused by the exercise of some right or privilege created by the State or by a rule of conduct imposed by the State,'" such as acts taken by a private entity pursuant to state law.[21] In addition, the claimant must establish that

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permitted to submit in writing to the URO their view regarding the reasonableness and necessity of the challenged treatment. *Sullivan*, 119 S. Ct. at 983 n.3. "The Bureau modified its procedures in response to the Court of Appeals' decision, and now provides for more extensive notice and an opportunity for employees to provide at least some input into the URO's decision." *Id.*

16. Certiorari is defined as "a writ of common law origin issued by a superior to an inferior court requiring the latter to produce a certified record of a particular case tried therein." BLACK'S LAW DICTIONARY 228 (6th ed. 1990). "The writ is issued in order that the court issuing the writ may inspect the proceedings and determine whether there have been any irregularities." *Id.*

17. *See Sullivan*, 119 S. Ct. at 984-85.

18. *See id.* The Court stated that:

> Perhaps hoping to avoid the traditional application of our state-action cases, respondents attempt to characterize their claim as a "facial" or "direct" challenge to the utilization review procedures contained in the Act, in which case, the argument goes, we need not concern ourselves with the "identity of the defendant" or the "act or decision by a private actor or entity" who is relying on the challenged law.

Id. (citing Brief for the Respondents 16). This argument, however, ignores the constitutional requirement of state action in order to find that an act violates the Fourteenth Amendment. *Id.*

19. *Id.* at 985. "Like the state-action requirement of the Fourteenth Amendment, the under-color-of-state-law element of § 1983 excludes from its reach 'merely private conduct, no matter how discriminatory or wrongful.'" *Id.*

20. *Sullivan*, 119 S. Ct. at 985; Lugar v. Edmondson Oil Co., 457 U.S. 922 (1982).

21. *Id.* (quoting *Lugar*, 457 U.S. at 937).

the party charged with the deprivation be a state actor, either "[b]ecause [the party] is a state official [or] because [the party] has acted together with or has obtained significant aid from state officials . . . ."[22]

The Supreme Court reasoned that while the private insurer's conformance to the Pennsylvania statute satisfies the first requirement, the plaintiffs failed to meet the second criterion.[23] The Court began by identifying "the specific conduct of which the plaintiff complains," namely, the suspended payment of disputed medical treatment.[24] Chief Justice William Rehnquist, writing for the majority, reasoned that a private insurer's decisions do not constitute state action simply because the private insurer is subject to state regulation.[25] In addition, the Court emphasized that in order to hold private insurers to Fourteenth Amendment standards, a sufficiently close nexus must exist between the state and the challenged action.[26]

The plaintiffs primarily argued that the decision to withhold payment may be fairly attributable to the Commonwealth because Pennsylvania encouraged private insurers to suspend payment when it amended its Workers' Compensation Act.[27] The Supreme Court rejected the plaintiffs' assertion, holding that the amendment to the Workers' Compensation Act merely shows that Pennsylvania, in managing the compensation of disabled employees, considers it appropriate to allow insurers to defer payment of a bill until the claim is substantiated.[28] Relying on *Blum v. Yaretsky*,[29] and reasoning that the Bureau's participation is limited to requiring insurers to file a properly completed form, the majority also rejected the argument that the private insurer's decision to suspend benefits is state action because insurers must first obtain

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22. *Lugar*, 457 U.S. at 937.

23. *See Sullivan*, 119 S. Ct. at 985-86.

24. *See id.* at 985.

25. *See id.* at 986.

26. *See id.* "Whether such a 'close nexus' exists . . . depends on whether the State 'has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State.'" *Id.*

27. *See id.* The amendment permits private insurers to request utilization review and suspend payment regarding disputed benefits until such review has been completed. *Id.* at 987.

28. *See Sullivan*, 119 S. Ct. at 987. The majority reasoned that state permission of an insurer's private choice cannot support a finding of state action that encourages private conduct. *Id.*

29. Blum v. Yaretsky, 457 U.S. 991 (1982).

authorization from the Bureau before withholding payment.[30]

Plaintiffs next contended that state action is present by advancing a twofold argument: (1) workers' compensation benefits are state-mandated public benefits that Pennsylvania is obligated to provide, and (2) Pennsylvania "has delegated to insurers the traditionally exclusive government function of determining whether [challenged] medical benefits may be suspended."[31] The majority refuted the first contention by holding that neither Pennsylvania's Constitution nor its statutory plan requires Pennsylvania to provide medical treatment or workers' compensation benefits to injured workers.[32] The Court also rejected the second contention by reasoning that neither historical practice nor the Pennsylvania statutory scheme classifies the decision to suspend payment for disputed medical treatment as an exclusive government function.[33]

Finally, the Court, stating that this case involved private entities providing services that the State is not obligated to furnish, opined that the plaintiffs incorrectly relied on the joint participation theory of state action.[34] Specifically, the plaintiffs reasoned that the joint participation theory is implicated because the Pennsylvania system "inextricably entangles the insurance companies in a partnership with [Pennsylvania] such that they become an integral part of [Pennsylvania] in administering the statutory scheme."[35] However, the majority found no state action, holding that joint participation requires something more than a private entity taking advantage of state-created and extensively regulated utilization review

30. *See Sullivan*, 119 S. Ct. at 987 (citing *Blum*, 457 U.S. at 1007). The Court cited *Blum* for the proposition that a state requirement that a private party complete a form does not convert the conduct of the private party into state action. *Sullivan*, 119 S. Ct. at 987. The court of appeals upheld the argument that the decision by private insurers to suspend benefits is state action because insurers must first obtain authorization from the Bureau before withholding payment. *Sullivan*, 139 F.3d at 158, 68.

31. *Sullivan*, 119 S. Ct. at 987.

32. *See id.* at 988.

33. *See id.* The Supreme Court has held that if "Pennsylvania first recognized an insurer's traditionally private prerogative to withhold payment, then restricted it, and now (in one limited respect) has restored it, [such decisions] cannot constitute the delegation of an exclusive public function." *Id.*

34. *See id.* (citing Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961)). Later cases, such as *Lugar v. Edmondson Oil Co.*, have redefined the vague "joint participation" test embodied in *Burton*, an early case dealing with "state action" under the Fourteenth Amendment. *Id.* State action arises under the joint participation theory in situations where the state and a private entity jointly participate in conformance to a state statutory scheme that deprives an individual of property without due process. Lugar v. Edmondson Oil Co., 457 U.S. 922, 941 (1982).

35. *Sullivan*, 119 S. Ct. at 988 (quoting *Sullivan*, 139 F.3d at 170).

procedures.[36]

Regarding the due process issue,[37] the Supreme Court, unlike the Court of Appeals, held to the rationale of *Mathews v. Eldridge*,[38] which prescribes that only after finding a deprivation of a protected interest should the Court address whether a state's procedures comport with due process.[39] As a result, the majority did not focus on what process is due, but rather first examined whether the Due Process Clause was implicated at all by the instant case.[40] In its analysis, the Court considered whether an employee possesses a property interest in having insurers pay for disputed medical treatment and held that a property interest arises only after a URO deems the medical treatment provided to be reasonable and necessary.[41] Consequently, Pennsylvania's permission for insurers to suspend payment of disputed medical benefits neither implicates nor violates Fourteenth Amendment due process guarantees concerning property rights.[42]

Plaintiffs asserted that once an employer's liability is established, the Pennsylvania workers' compensation law confers upon them a protected property interest concerning the consequent medical benefits.[43] Chief Justice Rehnquist held that Pennsylvania law expressly limits an employee's entitlement to only reasonable and necessary treatment and requires that disputes over the reasonableness and necessity of particular treatment be resolved before an employee's entitlement to benefits arise.[44] Hence, for an employee's property interest in the payment of medical benefits to attach under state law, the employee must prove: (1) "that an employer is liable for a work-related injury" and (2) "that the particular medical treatment at issue is reasonable and necessary."[45] The Court concluded that while the plaintiffs established the first prerequisite, they did not satisfy the second; therefore, plaintiffs did

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36. *See id.* at 989.

37. *See id.* "Though [its] resolution of the state-action issue would be sufficient by itself to reverse the judgment of the Court of Appeals, [the Supreme Court] believed that the [lower appellate] court fundamentally misapprehended the nature of the [plaintiffs'] property interests at stake in this case . . . . " *Id.*

38. 424 U.S. 319 (1976).

39. *See Sullivan*, 119 S. Ct. at 990.

40. *See id.*

41. *See id.*

42. *See id.* "[N]or shall any state deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV, § 1.

43. *See Sullivan*, 119 S. Ct. at 990.

44. *See id.*

45. *Id.*

not have any property interest on which to base their claim.[46]

Thus, the Court held that a private insurer's decision to withhold payment for disputed medical treatment does not constitute state action and the Due Process Clause does not prohibit insurers from withholding payment for disputed medical treatment pending utilization review.[47]

In a concurring opinion, Justice Ruth Bader Ginsburg agreed with the majority that the plaintiffs had no protected property rights at stake that could subject insurers to Fourteenth Amendment constraints.[48] However, Justice Ginsburg argued that the Court should have limited its analysis to such case-dispositive grounds, without analyzing the non-dispositive question of whether state action was present.[49]

Justice Stephen Breyer also concurred with the Court's opinion and its judgment, but added that an injured employee may have a constitutionally protected property interest when that person has a reasonable expectation of continued payments based on the receipt of earlier distributions.[50]

In a separate opinion, Justice Paul Stevens agreed that the Court of Appeals' judgment should be reversed with respect to the present modified procedures, which were implemented in response to the Court of Appeals' decision.[51] Justice Stevens, however, dissented from the majority by arguing that the controlling issue of the case is whether the Pennsylvania procedures were fair and not whether the insurance company was a state actor.[52]

In 1883, the *Civil Rights Cases* demonstrated the first significant articulation by the Supreme Court that Fourteenth Amendment rights are applicable only where state action is present.[53] The statute in question, the Civil Rights Act of 1875, clearly regulated private conduct, and the question before the Court was whether Congress had the power to enact such a statute.[54] The majority

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46. *See id.*

47. *See id.*

48. *See Sullivan*, 119 S. Ct. at 991 (Ginsburg, J., concurring).

49. *See id.* (Ginsburg, J., concurring).

50. *See id.* (Breyer, J., concurring).

51. *See id.* (Stevens, J., concurring in part and dissenting in part).

52. *See id.* at 992. (Stevens, J., concurring in part and dissenting in part).

53. Civil Rights Cases, 109 U.S. 3 (1883). The *Civil Rights Cases* involve the Civil Rights Act of 1875, in which Congress prohibited all persons (not just state governments) from denying, on the basis of race, any individual's equal access to inns, public transportation, theaters and other place of public accommodation. *Civil Rights Cases*, 109 U.S. at 4-5.

54. *See id.* at 8-9.

reasoned that the guarantees of equal protection and due process, given by the Fourteenth Amendment,[55] apply by their terms solely to state action and not private action.[56] Therefore, the 1875 Civil Rights Act was declared unconstitutional because it not only regulated racial discrimination by the states, but also racial discrimination that stemmed from purely private conduct.[57]

The narrow view of what constitutes state action, implicit in the *Civil Rights Cases*, remained in force until the 1940s; it was not until *Shelley v. Kraemer*[58] that the Supreme Court began to broaden its view of state action.[59] The *Shelley* Court wrestled with the issue of whether state courts could judicially enforce, without violating the Fourteenth Amendment, a racially restrictive covenant entered into by homeowners that their property would not be owned by anyone but Caucasians.[60] The Justices rationalized that this case did not involve the state remaining inactive while one private citizen discriminated against another. Rather, they determined that the state's judicial branch was enabling the discrimination to occur.[61] In addition, the Court reasoned that even the application of facially neutral laws, such as the enforcement of a private contract, might be construed as a commandment from the state to discriminate, thereby warranting a finding of state action.[62] Consequently, Chief Justice Fred Vinson, writing for the Court, held that the judicial enforcement of racially restrictive covenants *does* constitute state action, and such conduct violates the Fourteenth Amendment.[63]

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55. *See id.* at 11. "[N]or shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.

56. *See Civil Rights Cases*, 109 U.S. at 11.

57. *See id.* at 24.

58. 334 U.S. 1 (1948). *Shelley* involved the enforceability of racially restrictive covenants entered into by homeowners that their properties would only be owned by Caucasians. *Shelley*, 334 U.S. at 4. When African-Americans bought homes from willing Caucasian owners despite such covenants, other Caucasians, who were owners of properties also subject to the covenants, sued to block the African-Americans from taking possession. *Id.* at 6.

59. *See id.* at 8. "Whether the equal protection clause of the Fourteenth Amendment inhibits judicial enforcement by state courts of restrictive covenants based on race or color is a question which this Court has not heretofore been called upon to consider." *Id.*

60. *Id.*

61. *See id.* at 19. "[B]ut for the active intervention of the state courts, supported by the full panoply of state power, [defendants] would have been free to occupy the properties in question . . . . " Id.

62. *See id.* at 17-18.

63. *See Shelley*, 334 U.S. at 20.

The Supreme Court further broadened the concept of state action in 1961 with *Burton v. Wilmington Parking Authority.*[64] The question confronting the Court in *Burton* was whether state action exists when a state and a private discriminator are entangled in a mutually beneficial relationship.[65] Relying on the fact that the state's successful operation of a public facility was heavily dependent upon the privately-operated restaurant lease and the discrimination itself,[66] Justice Tom Clark found that the state had an affirmative obligation to insert a non-discrimination requirement in the lease.[67] Furthermore, the *Burton* Court held that this duty could not have been avoided even upon a showing by the state of good faith or a showing of a complete absence of motive to encourage discrimination.[68] In light of this symbiotic relationship between the private entity and the state, the majority attributed the discriminatory private conduct to the state and ruled that such conduct violated the Due Process Clause.[69]

In 1967, the Court once again expanded the concept of state action in *Reitman v. Mulkey*[70] by holding that state action may also arise where the state has encouraged discrimination.[71] In *Reitman,* California voters had amended the state constitution to prohibit the government from interfering with any private individual's right to discriminate in the sale or lease of residential real estate.[72] The

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64. 365 U.S. 715 (1961). *Burton* involved the relationship between a parking building owned and run by the Wilmington Parking Authority (a state agency), and a restaurant run by a private company within the building, under a lease with the Authority. *Burton,* 365 U.S. at 716. The restaurant refused to serve African-Americans and no provision in Delaware at the time required private companies to do so. *Id.* at 717. An African-American, who was refused service, contended that the Parking Authority's involvement with the restaurant was sufficient enough to connect the discrimination to state action, which is violative of the Fourteenth Amendment. *Id.* at 720.

65. *See id.* at 717.

66. *See id.* at 724. The project could not have been financed without rents from commercial tenants like the restaurant. *Id.* at 723-724. Furthermore, because the restaurant claimed that its business would be hurt if it were forced to serve African-Americans, the profits earned by discrimination were indispensable elements in the project's financial success. *Id.* at 724.

67. *See id.* at 725. Under state law regarding leases of public property, the Authority could have required the private restaurant not to discriminate. *Id.* at 720.

68. *See id.* at 725.

69. *See Burton,* 365 U.S. at 717, 726.

70. 387 U.S. 369 (1967).

71. *See Reitman,* 387 U.S. at 381.

72. *See id.* at 370-71. In a statewide ballot, California voters ratified Proposition 14, which provides in part:

> Neither the State nor any subdivision or agency thereof shall deny, limit or abridge, directly or indirectly, the right of any person, who is willing or desires to sell, lease or

Supreme Court affirmed the state court's decision to strike the constitutional amendment by holding that the amendment's purpose and effect[73] ultimately encourages discrimination, and that such encouragement constitutes state action in violation of the Fourteenth Amendment.[74] The *Reitman* Court indicated, however, that the mere failure by a state to forbid private discrimination would not constitute state action.[75] The Court then reasoned that even if the state enacted fair housing legislation and then repealed it, the repeal by the legislature would most likely not have been considered state action since such repeal would merely restore the status quo.[76]

After expanding the concept of state action from the 1940s through the 1960s, the Court then began to narrow the situations that would trigger state action with the 1972 case of *Moose Lodge No. 107 v. Irvis*.[77] In *Moose Lodge*, a private club refused service to a black guest of a club member.[78] The guest contended that, since the state had given the club one of a limited number of liquor licenses, this act of licensing and the act of regulating such a license was sufficient to render the club's discrimination as state action.[79] The Supreme Court disagreed, holding that the "detailed type of regulation" the state requires the club to adhere to in order to maintain the license "cannot be said to foster or encourage racial discrimination."[80] Furthermore, the *Moose Lodge* majority believed that the mere fact that a state grants a license to an entity does not transform the private entity's conduct into state action, even where the number of licenses is limited.[81]

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rent any part or all of his real property, to decline to sell, lease or rent such property to such person or persons as he, in his absolute discretion, chooses.

CAL. CONST. of art. I, § 26 (Proposition 14).

73. *See Reitman*, 387 U.S. at 381. An immediate effect and purpose of the constitutional amendment was to overturn two statutes that barred private residential housing discrimination. *Id.* at 374

74. *See id.* at 373, 381.

75. *Id.* at 376. Even giving *Reitman* a broad reading, it seems extremely unlikely that the mere failure by a state to forbid private discrimination constitutes state action. *Id.* Thus had California never enacted any legislation dealing with private housing discrimination, its inaction would almost certainly not be deemed state conduct. *Id.*

76. *See id.* at 380-81.

77. 407 U.S. 163 (1972).

78. *Moose Lodge*, 407 U.S. at 163.

79. *See id.* at 165.

80. *See id.* at 176-77. The Court distinguished this situation, which entails a private club in a private building, from that in *Burton*, where there was a symbiotic relationship between a privately operated restaurant and a publicly-owned building. *Id.* at 174-75.

81. *See id.* at 177. The majority suggested, however, that the result might have been

Two years later, the Supreme Court further constricted the theory of state action in *Jackson v. Metropolitan Edison.*[82] The *Jackson* Court addressed the issue of whether actions by an extensively regulated, natural monopoly are attributable to the state when this private entity performs a function that is public in nature.[83] Because state law did not require the state to furnish utilities, the majority concluded that the utility company did not exercise powers exclusively reserved to the state, thus there was not a sufficient relationship between the challenged actions of the private-owned utility and the government.[84] Furthermore, the Supreme Court rationalized that because the state did not grant the monopoly, the mere fact that the utility company, a natural monopoly, is subject to extensive state regulation does not by itself convert the utility company's action into that of the state.[85] Finally, the Court ruled that the utility's practice of terminating service for nonpayment, without giving notice or an opportunity to be heard, is not transformed into state action solely based on the state's acquiescence in the matter.[86]

Unlike the previous holdings of the 1970s, the Court, in the 1982 case of *Lugar v. Edmondson Oil Co.*,[87] found the necessary state involvement where a private party and a state official had jointly participated in the activity being challenged.[88] The question before the *Lugar* Court was whether a creditor, in conformance with a state statutory scheme, could obtain a pre-judgement attachment of a debtor's property without the debtor first having notice or an

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different if the licenses were limited in such a way that clubs holding them had a monopoly in the dispensing of liquor. *Id.*

82. 419 U.S. 345 (1974). *Jackson* involved an individual's claim that termination of electric service for alleged nonpayment by a state certified, privately owned and operated utility corporation constituted state action, which deprived the claimant of property without due process of law. *Jackson*, 419 U.S. at 347-48.

83. *See id.* at 350-51.

84. *See id.* at 352-53.

85. *See id.* at 351-52. Natural monopolies, areas of commerce where only one business can profitably operate due to capital requirements, are often highly regulated because no competition exists to keep their charges reasonable. *Id.* at 351 n.8.

86. *See id.* at 354. "[The utility company] filed with the Public Utility Commission a general tariff, a provision . . . which states [the utility company's] right to terminate service for nonpayment." *Id.*

87. 457 U.S. 922 (1982). Lugar involved a creditor's right to seize or dispose of his debtor's property. *Lugar*, 457 U.S. at 922. In particular, the creditor (Edmondson) sued to collect a debt and obtained a pre-judgement attachment against the property of the debtor (Lugar), which had the effect of preventing the debtor from being able to sell the property though the debtor remained in possession. *Id.* at 924-25.

88. *See id.* at 923.

opportunity to be heard.[89] Justice Byron White, delivering the opinion of the Court, stated that because government officials, acting under color of state law, acted together with a private creditor, the creditor could be held liable for violating the debtor's due process rights as defined by the Fourteenth Amendment.[90] In addition, the *Lugar* majority held that private misuse of a properly drafted statute is not state action that can give rise to constitutional deprivation because such misuse is not commanded by a rule of conduct imposed by the state.[91]

Since the 1980s, the Supreme Court has taken a quite narrow view of the circumstances that transform private conduct into state action via the state commanding particular actions of a private entity; *Blum v. Yarestsky*[92] evidences this viewpoint.[93] The *Blum* Court confronted the issue of whether decisions by a private entity that affect constitutionally protected property interests of Medicaid patients,[94] without the patients having prior notice or an opportunity to be heard, constitute state action that is subject to the strictures of the Fourteenth Amendment.[95] The Supreme Court reasoned that any real degree of discretion delegated to a private party will be enough to relieve the state of responsibility for those private actions, even though such conduct takes place within a fairly rigid framework of state-created rules.[96] As in *Jackson*, the

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89. *See id.* at 922. To obtain the attachment, the creditor was required only to file an ex parte petition stating a belief that his debtor might dispose of the property in order to defeat the creditor's claim; a clerk of the court then issued a writ of attachment, which was executed by the sheriff. *Id.* at 924.

90. *See id.* at 942.

91. *See Lugar*, 457 U.S. at 941.

92. 457 U.S. 991 (1982). In *Blum*, a class of Medicaid patients in private nursing homes unsuccessfully claimed that decisions, by the home's utilization review committee of physicians to discharge them or send them to facilities giving less extensive service, constituted state action that denied them of property rights without due process of law. *Blum*, 457 U.S. at 993, 995-996.

93. *See id.* at 992-93.

94. *Id.* at 993-94. "Congress established the Medicaid program in 1965 as Title XIX of the Social Security Act, 42 U.S.C. § 1396 to provide federal financial assistance to States that choose to reimburse certain medical costs incurred by the poor." *Id.* "As a participating state, New York provides Medicaid assistance to eligible persons who receive care in private nursing homes . . . . " *Id.* at 994. In order to qualify for Medicaid assistance, a patient "must satisfy eligibility criteria defined in terms of income . . . and he must seek medically necessary services" as defined by a utilization review committee of physicians, who are not controlled by the state. *Id.* at 1005-06.

95. *See id.* at 993, 998.

96. *See id.* at 1004-07. The actual discharge or transfer decisions were based on medical judgements, which were made by independent nursing home professionals who were not controlled by the state. *Id.* at 994-95.

Blum majority also rationalized that before ruling that a private individual is an agent of the state, the challenged activity must be a function that the state constitution or a state statute requires the state to provide.[97] Because the nursing home was able to exercise its own discretion, and the state is not exclusively required to provide nursing care, the Court held that decisions by a nursing home's utilization review committee of physicians does not constitute state action.[98]

In addition to refining the concept of state action, during the early 1970s, the Supreme Court, in cases such as *Goldberg v. Kelly*,[99] found many types of government benefits to be property interests that could not be taken without procedural due process.[100] In *Goldberg*, the issue was whether welfare entitlements are rights guaranteed by the Constitution, and if so, what process is due when the state deprives an individual of such a right.[101] The *Goldberg* Court held that, if a person was presently entitled under statute to receive welfare, such payment was a right protected by the Fourteenth Amendment against subsequent arbitrary withdrawal by the state.[102] By weighing the recipient's interest in avoiding loss against the governmental interest of summary adjudication, the majority ruled that the full panoply of procedural

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97. *See Blum*, 457 U.S. at 1005.

98. *See id.* at 1005, 1006, 1012. "To assure that nursing home services are medically necessary, federal law requires that a physician so certify at the time the Medicaid patient is admitted and periodically thereafter." *Blum*, 457 U.S. at 1006 (citing 42 U.S.C. § 1396b(g)(1) (1976)). "New York requires that the physician complete a 'long-term care placement form' . . . [that] provides a numerical score corresponding to the physician's assessment of the patient's health." *Id.* "[T]he physicians, and not the forms, make the decision whether the patient's care is medically necessary" such that "a physician can authorize a patient's admission to a nursing facility despite a 'low' score on the form." *Id.*

99. 397 U.S. 254 (1970). *Goldberg* involved a complaint by federal welfare recipients who alleged that New York state, in administering welfare programs, terminated aid without first providing prior notice or a hearing, thereby denying them due process of law. *Goldberg*, 397 U.S. at 255-56.

100. *See id.* at 264, 269-70. Due process of law is defined as "a course of legal proceedings according to those rules and principles which have been established in our systems of jurisprudence for the enforcement and protection of private rights." BLACK'S LAW DICTIONARY 500 (6th ed. 1990). Furthermore, the phrase is expressed in the Fourteenth Amendment to the U.S. Constitution: "[n]or shall any state deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV, § 1.

101. *See Goldberg*, 397 U.S. at 254.

102. *See id.* at 262. By proving unable to support themselves or secure support from other sources, the claimants had already qualified, prior to the termination proceedings, to receive financial aid under the federally assisted and state administered program of Aid to Families with Dependent Children (AFDC) or under New York State's general Home Relief Program. *Id.* at 256.

safeguards, such as an evidentiary hearing,[103] the right to counsel,[104] and the right to cross-examine,[105] was required because the termination involves state action that adjudicates rights that are constitutionally protected.[106]

Concerned that the government would become paralyzed by the continual expansion of governmental benefits deemed to be interests in property, the Burger Court, in *Board of Regents v. Roth*,[107] began to curtail the types of public benefits that would be considered to create a property interest.[108] In *Roth*, the plaintiff, a non-tenured professor under a one-year contract to teach at Wisconsin State University, alleged that the decision not to rehire him, without first giving notice or an opportunity to be heard, infringed his Fourteenth Amendment rights.[109] Justice Potter Stewart's opinion in *Roth* emphasized that, only after determining that the plaintiff's claim includes a property interest that implicates the protection of the Fourteenth Amendment, should the Court weigh the importance of such an interest by identifying the procedural due process protections.[110] In determining the existence of a property right, the Court rationalized that the plaintiff must possess a legitimate claim of entitlement that is created and defined by state law.[111] In addition, the *Roth* Court observed that the Fourteenth Amendment due process protection of property rights only applies to interests that a person has already acquired.[112] Because Wisconsin law explicitly empowered university officials to make discretionary rehiring decisions, the *Roth* majority held that although Roth had an abstract concern in being rehired, he had no such entitlement that would require university officials to adhere to the strictures of the Due Process Clause.[113]

Despite *Roth's* severe approach, the companion case of *Perry v.*

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103. *See id.* at 264.

104. *See id.* at 270.

105. *See id.* at 269.

106. *See Goldberg*, 397 U.S. at 262.

107. 408 U.S. 564 (1972).

108. *Roth*, 408 U.S. at 579.

109. *See id.* at 569.

110. *See id.* at 571-72.

111. *Id.* at 577. The Constitution does not bring about property interests, but rather property interests "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . . . " *Id.* Under Wisconsin law, decisions on hiring non-tenured positions were left totally to the discretion of University officials. *Id.* at 566-68 n.2-4.

112. *Id.* at 576.

113. *See Roth*, 408 U.S. at 578-79.

Sindermann[114] indicates that informal practices or customs may be sufficient to create a legitimate claim of entitlement.[115] The issue confronting the *Perry* Court was whether the plaintiff, a college professor, possessed tenure right to reemployment created by informal conduct and rules of the college administration and the college's alleged de facto tenure program.[116] The *Perry* majority found a person's claim to a benefit to be a property interest if rules or mutually explicit understandings exist to support such an assertion.[117] As a result, the Court held that the college must afford the plaintiff the opportunity to prove the legitimacy of his entitlement claim prior to terminating his property interest.[118]

At last, in the 1976 seminal case of *Mathews v. Eldridge*,[119] the Court, convinced that a full set of procedural guarantees as defined in *Goldberg* would become extremely expensive, time-consuming, and perhaps administratively impossible, cut back on its interpretation of exactly what procedures are required where a property interest is at issue.[120] The question facing the *Mathews* Court was whether the Due Process Clause requires that the recipient of disability benefit payments be afforded an evidentiary hearing prior to termination.[121] After finding disability benefits to be

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114. 408 U.S. 593 (1972). The plaintiff in *Perry*, like in *Roth*, was untenured; however, after teaching for ten years, his employment contract terminated and was not renewed for the next academic year. *Perry*, 408 U.S. at 594-95. Furthermore, the college administration provided Sindermann, the plaintiff, no official statement regarding the reasoning behind the non-renewal of his contract and no opportunity for a hearing to challenge the non-renewal decision. *Id.* at 595.

115. *Id.* at 601-02.

116. *Id.* at 596, 599-600. De facto is a phrase used to characterize an action or state of affairs that must be accepted for all practical purposes, but is illegal or illegitimate. BLACK'S LAW DICTIONARY 416 (6th ed. 1990). Plaintiff asserted that for ten years he legitimately relied upon an unusual provision that had been in the college's official Faculty Guide for many years: "Teacher Tenure: Odessa College has no tenure system." *Perry*, 408 U.S. at 600. "The Administration of the College wishes the faculty member to feel that he has permanent tenure as long as his teaching services are satisfactory and as long as he displays a cooperative attitude toward his co-workers and his superiors, and as long as he is happy in his work." *Id.*

117. *See id.* at 600-02.

118. *See id.* at 601, 604.

119. 424 U.S. 319 (1976). *Mathews* involved the termination of disability benefits solely based on written correspondences between the recipient and a state agency charged with monitoring his medical condition. *Mathews*, 425 U.S. at 323-324. In May 1972, the state agency made its final determination that Eldridge had ceased to be disabled. *Id.* at 324. Eldridge was then notified of the termination as well as his right to seek reconsideration. *Id.* "Instead of requesting reconsideration, Eldridge commenced this action challenging the constitutional validity of the administrative procedures . . . . " *Id.* at 324-25.

120. *Id.* at 321.

121. *Id.* at 323.

a constitutionally protected property interest, the majority called for a balancing test to determine what process is due before the recipient can be deprived of such an interest.[122] In applying the test, the Court held that disability payments, unlike the welfare payments at issue in *Goldberg*, are less likely a sole source of income, thus the individual possesses a lower stake in such an interest.[123] In addition, the Court found that the value of an evidentiary hearing is less than in *Goldberg* because the disability issue turned upon a medical assessment of the worker's physical condition, which could properly be evaluated through written documents rather than oral testimony.[124] Furthermore, the *Mathews* majority ruled that the burden of supplying a full administrative hearing was likely to be substantial, and the cost of it "may [ultimately] come out of the pockets of the deserving since resources available for any particular [social welfare] program are not unlimited."[125] As a result, the Court concluded that no evidentiary hearing was required before the termination of disability benefits.[126]

Based on this review of Supreme Court precedents regarding state action and due process, the Supreme Court in *Sullivan*[127] correctly determined that no protected property interests were at stake. However, the Court should have limited its analysis of this controversy to the dispositive property interest issue, instead of including in its analysis the non-dispositive issue of state action. Furthermore, the *Sullivan* Court's holding on the state action issue is incorrect.

In not finding state action, the *Sullivan* Court failed to realize that when Pennsylvania amended its Workers' Compensation Act to allow insurers to suspend payments while the disputed medical treatment is under utilization review, the Commonwealth encouraged private insurers to withhold medical benefits. This encouragement is substantially similar to the unconstitutional state

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122. *See id.* at 335. Interest by an individual in continued receipt of social security benefits is a statutorily created property interest protected by the Due Process Clause. *Id.* at 332-33. The balancing test weighed the strength of the private interest affected by the official action and the risk of an erroneous deprivation of such interest against the government's interest, including the function involved and administrative burdens that a due process procedural requirement would entail. *Id.* at 335.

123. *See id.* at 340-41.

124. *See Mathews*, 424 U.S. at 344.

125. *Id.* at 347-348.

126. *See id.* at 349.

127. 119 S. Ct. 977 (1999).

encouragement that the Supreme Court found in *Rietman*[128] when California amended its constitution to prohibit the government from interfering with discriminatory real estate sales. In addition, the impetus behind Pennsylvania's workers' compensation program is that Pennsylvania is constitutionally obligated to provide for the welfare of its citizens.[129] By delegating to insurers the traditionally exclusive government function of determining what "reasonably" and "necessarily" provides for citizen welfare, the act of suspending payment by private insurers becomes attributable to the state. Furthermore, if property interests were at issue, the practical impact of this holding would allow Pennsylvania to sanctify, free from the strictures of the Fourteenth Amendment, private insurers' deprivation of individual property rights. For these reasons, the *Sullivan* Court erred in finding no state action. The state action issue was not, however, a dispositive matter.

Concerning the dispositive issue of property interests, the plaintiffs in *Sullivan*, unlike *Goldberg*,[130] were not entitled under state statute to receive payment for medical treatment until such treatment was deemed reasonable and necessary. Since the plaintiffs failed to show medical treatment received to be reasonable and necessary, the *Sullivan* Court correctly held that no property interests were at stake. As a result, the insurers were not subject to Fourteenth Amendment constraints and could thereby, without adhering to due process guarantees, withhold workers' compensation benefits.

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128. *See supra* text accompanying notes 70-72.

129. *See* PA. CONST. Art. I, § 1. "All men are born equally free and independent, and have certain inherent and indefeasible rights, among which are those of enjoying and defending life and liberty, of acquiring, possessing and protecting property and reputation, and of pursuing their own happiness." *Id.*

130. *See supra* text accompanying note 99.