No. S203124

IN THE SUPREME COURT OF CALIFORNIA

JERRY BEEMAN and PHARMACY SERVICES et al.,

Plaintiffs-Respondents,

v.

ANTHEM PRESCRIPTION MANAGEMENT et al.,

Defendants-Appellants.

Question Certified from the En Banc United States Court of Appeals for the Ninth Circuit, Case Nos. 07-56692, 07-56693

APPELLANTS' CONSOLIDATED REPLY BRIEF

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INTRODUCTION

The Ninth Circuit certified a straightforward question to this Court: "Does California Civil Code section 2527 compel speech in violation of article I, section 2 of the California Constitution?" The answer to this question is "yes," and plaintiffs are wrong in asserting that Civil Code section 2527 is exempt from *any* constitutional review. The statute targets specific content (the fee studies) and a specific speaker (the drug claims processers), and compels the claims processers not only to compile, but also to *summarize* and disseminate fee studies against their interest. This regulation of speech requires and fails strict constitutional scrutiny.

Plaintiffs' claim that section 2527 is immune from *any* constitutional scrutiny, and (even worse) their claim that the only speech triggering such scrutiny must rise to core political speech such as the Pledge of Allegiance, lack any legal support and fly in the face of plaintiffs' own authorities and the plain text of California's broad free speech clause. As the *en banc* Ninth Circuit recognized, "[a]llowing the government free reign to compel speech as long as the speech is factual would open up almost all speech to regulation," and "[n]o federal or California precedent supports the conclusion that

compelled, factual, non-commercial speech is beyond the ambit of California's constitution." (*Beeman v. Anthem Prescription Management, LLC* (9th Cir. 2012) 689 F.3d 1002, 1010 (*en banc*) (*Beeman III*).)

Both this Court and the United States Supreme Court have held on multiple occasions that a statute compelling the disclosure of statistical data is subject not only to constitutional protection, but to strict scrutiny under either California's free speech clause or the First Amendment. And every California court to decide this issue (two trial courts and three intermediate appellate panels) applied these precedents and unanimously concluded that section 2527's reporting requirement violates article I, section 2 of the California Constitution.

A holding that the free speech clause applies effectively resolves the question certified by the Ninth Circuit, because section 2527 fails under any level of scrutiny. The compelled speech at issue is not subject to lesser scrutiny as "commercial speech" because the speech is unrelated to any commercial "transaction" and is not driven by a profit motive. And, because section 2527 does not regulate false or misleading speech, lesser scrutiny is also unwarranted.

Plaintiffs' repeated attempt to tie section 2527 to some sort of consumer interest has no basis in the statute's legislative history or the allegations in their complaint. Section 2527 was enacted in an attempt to help *businesses* (pharmacies) obtain higher reimbursements from other businesses (claims processors). It was not intended to—nor could it—help consumers. If anything, the legislative history demonstrates that this special interest statute would *increase* the cost of health care in this State. For this reason, plaintiffs' "parade of horribles" is substantively and analytically inapposite. As the court of appeal found in a virtually identical case, the "information required by section 2527 is not necessary to protect the public health or safety, or even the public fisc; it is not aimed at protecting consumers, or insurers, from being misled." (*ARP Pharmacy Services, Inc. v. Gallagher Bassett Services, Inc.* (2006) 138 Cal.App.4th 1307, 1318 (*ARP*).)

Nor is there any basis for plaintiffs' repeated hypotheticals about claims processors that mislead their clients. Plaintiffs have alleged no such thing in this case, and their attempt to delay adjudication of the constitutional issue presented here based on the

potential that section 2527 might be constitutional as applied in some other case is completely unwarranted.

The California courts have uniformly, and correctly, held that section 2527 is unconstitutional under the California free speech clause, and the Ninth Circuit panel's holding otherwise was incorrect. This Court should therefore hold that section 2527 compels speech in violation of article I, section 2 of the California Constitution.

DISCUSSION

I. Section 2527 Compels Speech And Therefore Triggers Constitutional Scrutiny

Plaintiffs do not cite a single case in which a statute such as section 2527 that compels speech was immune from *any* constitutional scrutiny, and there is none. Regardless of which level of scrutiny applies—strict scrutiny (see *Sorrell v. IMS Health Inc.* (2011) 131 S.Ct. 2653 (*Sorrell*)), intermediate scrutiny (see *Kasky v. Nike* (2002) 27 Cal.4th 939 (*Kasky*)), or some lesser scrutiny (see *Zauderer v. Office of Disciplinary Counsel for Supreme Ct. of Ohio* (1985) 471 U.S. 626 (*Zauderer*))—there is no doubt that section 2527, which requires defendants to transmit a specific message against their wishes, triggers *some* protection under the free speech clause.

Plaintiffs' suggestion (and the Ninth Circuit panel majority's now-vacated holding) to the contrary is incorrect.

Every court in this State to confront the issue has held that section 2527 triggers constitutional scrutiny. (See *ARP*, *supra*, 138 Cal.App.4th 1307; accord *A.A.M. Health Group, Inc. v. Argus Health Systems, Inc.* (Cal.Ct.App. Feb. 28, 2007, No. B183468) 2007 WL 602968 (*A.A.M.*); *Bradley v. First Health Services Corp.* (Cal.Ct.App. Feb. 28, 2007, No. B185672) 2007 WL 602969, review den. June 13, 2007 (*Bradley*).) These courts have relied heavily on the United States Supreme Court's First Amendment jurisprudence, which has established that "[m]andating speech that a speaker would not otherwise make necessarily alters the content of the speech." (*ARP*, at p. 1315, citing *Riley v. Nat. Federation of the Blind* (1988) 487 U.S. 781, 795 (*Riley*).)

Moreover, these decisions applied the free speech guarantees in the California Constitution, which are "'more protective, definitive and inclusive of rights to expression and speech' than the First Amendment ...." (*Glendale Associates, Ltd. v. NLRB* (9th Cir. 2003) 347 F.3d 1145, 1154; see also *Gerawan Farming, Inc. v. Lyons* (2000) 24 Cal.4th 468, 497–498 (*Gerawan*); *Blatty v. New York Times Co.*

(1986) 42 Cal.3d 1033, 1041.) It is because of these broader protections that the *en banc* Ninth Circuit vacated the panel majority's decision and explained that "federal courts should be wary of constraining the scope of California's free speech clause." (*Beeman III, supra*, 689 F.3d at p. 1008.)

Plaintiffs' contention that the California Constitution protects only *some* forms of speech flies in the face of the Constitution's plain language, which guarantees the "right" to "freely speak, write and publish his or her sentiments *on all subjects*." (Cal. Const., art. I, § 2, subd. (b), italics added.) This Court thus held in *Gerawan* that "article I's right to freedom of speech ... is *unlimited in scope*." (*Gerawan, supra*, 24 Cal.4th at p. 493, italics added.)

Plaintiffs' attempt to limit the reach of the California Constitution (or the First Amendment) to speech like the Pledge of Allegiance is an egregiously high bar that very little speech would satisfy. Their argument creates a dangerous slippery slope that lacks any legal support. As the *en banc* Ninth Circuit explained:

> Allowing the government free reign to compel speech as long as the speech is factual would open up almost all speech to regulation—"Facts, after all, are the beginning point for much of the speech that is most essential to advance human knowledge and to conduct human affairs." *See, e.g., Sorrell*, 131 S. Ct. at 2667. ***No***

> ***federal or California precedent supports the conclusion that compelled, factual, non-commercial speech is beyond the ambit of California's constitution.***

(See *Beeman III*, *supra*, 689 F.3d at p. 1010, italics added.)

For example, the Ninth Circuit held recently that even the Yellow Pages phonebook is protected speech, and that a regulation imposing fees and requiring an opt-out registry was subject to (and failed) strict scrutiny. (*Dex Media West, Inc. v. City of Seattle* (9th Cir. 2012) 696 F.3d 952, 953.) The court explained: "The First Amendment does not make protection contingent on the perceived value of certain speech." (*Id.* at p. 964; see also *United States v. Alvarez* (2012) 132 S.Ct. 2537, 2544 [listing "the few '"historic[al] and traditional categories [of expression]"'" that have been exempted from First Amendment scrutiny]; *United States v. Stevens* (2010) 130 S.Ct. 1577, 1585 [rejecting as "startling and dangerous" a "free-floating test for First Amendment coverage ... [based on] an ad hoc balancing of relative social costs and benefits"].) Even *Pharmaceutical Care Management Assn. v. Rowe* (1st Cir. 2005) 429 F.3d 294 (*PCMA*), on which plaintiffs rely heavily, holds that compelled factual disclosures implicate the First Amendment. (*Id.* at p. 316.)

This Court's precedents similarly do not constrict the nature of speech that qualifies for protection under California's free speech clause. Contrary to plaintiffs' claim (RB39), this Court in *Kasky* did not hold or suggest that the regulation of non-ideological speech is outside the protections of the free speech clause. The issue presented in *Kasky* was whether the speech at issue (Nike's denial of allegations about its labor practices) was "commercial," and thus whether intermediate, rather than strict, scrutiny applied. (*Kasky*, *supra*, 27 Cal.4th at p. 946.) The Court applied intermediate scrutiny and upheld the statute against constitutional challenge (*id.* at p. 994), but there is no suggestion in the Court's opinion that the free speech clause was somehow inapplicable.

Plaintiffs' restrictive view of the Free Speech Clause and the First Amendment is startling and dangerous. Under this view, a California statute requiring *the press* to disclose non-ideological facts would not warrant *any* constitutional scrutiny, because the information would be raw "factual" data and would not express an ideological message. Plaintiffs are overreaching in trying to exempt numerous forms of speech from any constitutional scrutiny whatsoever.

Plaintiffs also are wrong that *Kasky* distinguished the United States Supreme Court's decision in *Riley* "on the very ground that makes *Riley* inapplicable here." (RB12.) *Kasky* noted that the speech in *Riley* was not "commercial speech" and also quoted the Supreme Court's statement in *Board of Trustees, State Univ. of N.Y. v. Fox* (1989) 492 U.S. 469 (*Fox*), that in *Riley*, "the commercial speech (if it was that) was 'inextricably intertwined' [with the non-commercial speech] because the state law required it to be included." (*Id.* at p. 474.) But, again, this discussion in both *Riley* and *Fox* was relevant only to the question whether the speech was commercial, not whether constitutional scrutiny was applicable at all. (*Riley*, *supra*, 487 U.S. 781 at pp. 795–796; *Fox*, at pp. 473–474.) Nothing in *Kasky*, *Riley*, or *Fox* suggests that commercial or non-commercial speech is immune from any constitutional review. This conclusion is particularly inappropriate in the context of California's *broader* free speech protections. (See *Beeman III*, *supra*, 689 F.3d at pp. 1008–1009; *Best Friends Animal Society v. Macerich Westside Pavilion Proposition LLC* (2011) 193 Cal.App.4th 168, 174 ["Even though the *First Amendment* does not protect the right to free speech in a privately owned shopping mall, the California Constitution does"].)

The Ninth Circuit panel's (now-vacated) majority opinion characterized *Riley* as holding that only compelled speech that "alters the content of speech" "that the speaker would not otherwise make" is subject to constitutional review. (*Beeman v. Anthem Prescription Management, LLC* (9th Cir. 2011) 652 F.3d 1085, 1110 (*Beeman II*).) But as defendants showed in the opening brief, this was a misreading of *Riley*, because the portion of the Supreme Court's opinion the panel majority referenced related to the *application* of strict scrutiny (see *Riley*, *supra*, 487 U.S. at p. 795), not *whether* any constitutional scrutiny applied (see AOB45). Plaintiffs do not respond to this point. The same is true of plaintiffs' claim that in *Riley* the disclosures were mandated at the same time as the charitable solicitation (RB29)—*Riley* held that the simultaneous disclosures were a reason the statute failed strict scrutiny, but it did not suggest that this feature was the basis for constitutional scrutiny in the first place (487 U.S. at p. 798).

Plaintiffs continue to rely on the Ninth Circuit panel's reading of *Rumsfeld v. Forum for Academic & Institutional Rights, Inc.* (2006) 547 U.S. 47 (*FAIR*), without responding to the arguments that defendants made in the opening brief. *FAIR* did not hold that only "political messages," such as the "Government-mandated pledge or

motto" at issue in *Wooley* and *West Virginia State Board of Education v. Barnette* (1943) 319 U.S. 624, are entitled to First Amendment protection; the Court's holding was that the statute in *FAIR* did not regulate "speech" at all. (See AOB15.) The Court said explicitly that "compelled statements of *fact* ('The U.S. Army recruiter will meet interested students in Room 123 at 11 a.m.'), like compelled statements of *opinion*, are subject to First Amendment scrutiny." (*FAIR*, at p. 62, italics added.)

Plaintiffs' one response on *FAIR* is buried in a footnote and purports to respond to a decision (*Porter v. Bowen* (9th Cir. 2007) 496 F.3d 1009) that, contrary to plaintiffs' claim, defendants did not cite in the opening brief. (RB22, fn. 4.) *Porter* said that the difference between "pure speech" and "expressive conduct" "is often difficult to discern." (496 F.3d at p. 1021.) But the Ninth Circuit concluded that in *FAIR*, "law schools' exclusion of military recruiters from campus was not expressive *conduct*." (*Id.* at p. 1019, fn. 10, italics added.)[1] Plaintiffs also quote the statement in *FAIR* that sending emails and posting notices are speech (*FAIR*, *supra*, 547 U.S. at pp. 61–62), but

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[1] In addition, the distinction between speech and expressive conduct "ma[de] no practice difference" in *Porter*, so any discussion of *FAIR* was dicta. (496 F.3d at p. 1021.)

ignore the Supreme Court's conclusion that the Solomon Amendment *did not compel this speech.* (*Id.* at p. 62 ["The Solomon Amendment ... d[id] not dictate the content of the speech at all, which is only 'compelled' if, and to the extent, the school provides such speech for other recruiters"].)

Plaintiffs also expressly ignore the political context in which defendants' speech is being compelled. (See RB17 ["What public debate over reimbursement rate regulation?"].) The context, however, could not be clearer: The original bill (AB2044) would have required claims processors to reimburse pharmacies at "customary charges." (*Beeman v. TDI Managed Care Services, Inc.* (2006) 449 F.3d 1035, 1038 (*Beeman I*).) That bill was defeated, and a compromise bill—section 2527—was passed. (*ARP*, *supra*, 138 Cal.App.4th at p. 1319.)[2] But that has not ended the debate, as the pharmacists themselves have argued that dissemination of the studies under section 2527 could inspire "lobby[ing] for legislative intervention

[2] Plaintiffs' claim that the version of the bill that passed was "supported by both the pharmacies and the [PBM] industry" is patently untrue. (RB6.) Plaintiffs cite no supporting legislative history, and there is none.

should that be necessary" if higher, negotiated reimbursement rates are not achieved. (*Beeman I*, at p. 1039.)

Sorrell removes any doubt that section 2527 must pass constitutional muster even if the speech compelled is "dry information, devoid of advocacy, political relevance, or artistic expression." (131 S.Ct. at pp. 2666–2667.) Plaintiffs' passing, one-paragraph response to *Sorrell* is inadequate, as was the Ninth Circuit panel majority's footnoted treatment of that decision. Plaintiffs properly describe *Sorrell* as holding that "state statutes that restrict protected speech based on its content or viewpoint [are] subject to constitutional scrutiny" (RB28), but plaintiffs do not explain why the same is not true of section 2527 (see AOB26–27). Just like the statute in *Sorrell*, section 2527 targets specific content—"the results of a study … which identifies the fees … of all … California pharmacies," as well as "an explanatory summary of the results and findings" (Civ. Code, § 2527, subd. (c))—and specific speakers—"prescription drug claims processors" (*id.*, subd. (b)). As Judge Wardlaw explained, "[t]he Vermont law in [*Sorrell*] is the flip side of California's § 2527; they involve similar speech that Vermont prohibits and California

compels." (*Beeman II*, *supra*, 652 F.3d at p. 1111 [dis. opn. of Wardlaw, J.].)

Notably, plaintiffs have abandoned the only distinction drawn by the Ninth Circuit panel majority between *Sorrell* and the present case—that *Sorrell* dealt with a *restriction* on speech, whereas section 2527 *requires* speech. (See *Beeman II*, *supra*, 652 F.3d at p. 1101, fn. 17.) In doing so, plaintiffs implicitly acknowledge that this distinction is constitutionally insignificant, as both this Court and the United States Supreme Court have held on numerous occasions. (AOB17, 22–23; see, e.g., *Riley*, *supra*, 487 U.S. at p. 796 [the "difference between compelled speech and compelled silence ... is without constitutional significance"]; *Wooley v. Maynard* (1977) 430 U.S. 705, 714 ["the right of freedom of thought protected by the First Amendment against state action includes both the right to speak freely and the right to refrain from speaking at all"]; *Gerawan*, *supra*, 24 Cal.4th at p. 491 [the free speech clause protects "both a right to speak freely and also a right to refrain from doing so at all"].)

Plaintiffs rely on a series of other cases in seeking to immunize section 2527 from any constitutional scrutiny, but none holds or suggests, as plaintiffs claim, that section 2527 "does not warrant

constitutional scrutiny." (RB13, 25–26.) In all the cases plaintiffs cite, the courts upheld statutes against First Amendment challenge, but not because no constitutional scrutiny applied.[3]

* * *

Section 2527 compels prescription drug claims processors to compile, summarize, and disseminate information on pharmaceutical fees, and as such necessarily triggers constitutional scrutiny under the First Amendment and California's free speech clause. The protections of article I, section 2 extend to speech "on all subjects," and the speech compelled by section 2527 is not exempted. Whether strict, intermediate, or some lesser form of scrutiny applies, there can be no doubt that *some* level of scrutiny applies to the statute.[4]

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[3] (See *United States v. Sundel* (8th Cir. 1995) 53 F.3d 874, 878; *Scope Pictures of Mo., Inc. v. City of Kansas City* (8th Cir. 1998) 140 F.3d 1201, 1207; *Lake Butler Apparel Co. v. Secretary of Labor* (5th Cir. 1975) 519 F.2d 84, 89.)

[4] Plaintiffs' suggestion (RB9–10) that some defendants waived the First Amendment challenge to section 2527 is false, beyond the scope of the question certified by the Ninth Circuit, and wrong as a matter of law. (See, e.g., *Owens v. Kaiser Foundation Health Plan, Inc.* (9th Cir. 2001) 244 F.3d 825, 827 [a defendant "may ... raise an affirmative defense for the first time in a motion for judgment on the pleadings"].) Nor did defendants concede that there would be no free speech concerns with requiring pharmacists to provide the statistical data compelled by section 2527, as plaintiffs claim. (See RB20.) Defendants' point was simply that

II. Section 2527 Is Subject To And Fails Strict Scrutiny

The Ninth Circuit panel majority held that *no* constitutional scrutiny was warranted, and did not address the level of scrutiny or whether section 2527 satisfied the appropriate level of scrutiny. (See *Beeman III*, *supra*, 689 F.3d at pp. 1008, 1009.) The *en banc* court noted that "the question is whether section 2527 is subject to *some* level of constitutional review because it compels speech in violation of California's free speech clause and the First Amendment." (*Id.* at p. 1009, italics added.) Section 2527 should be invalidated under any level of constitutional scrutiny. Every state trial and appellate court to adjudicate the issue has held that section 2527 violates the First Amendment and California's free speech clause. (See *ARP*, *supra*, 138 Cal.App.4th 1307; *A.A.M.*, *supra*, 2007 WL 602968; *Bradley*, *supra*, 2007 WL 602969.)

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such a regulatory scheme would be more narrowly tailored. (See AOB30–31.) In any event, as even the panel majority acknowledged, section 2527 requires disclosure of more than statistical data. (See *Beeman II*, *supra*, 652 F.3d at p. 1100, fn. 13; see also *Beeman III*, *supra*, 689 F.3d at p. 1005 ["The statute requires drug claim processors to generate studies about pharmacy pricing, *summarize the results* and disseminate the information to their clients"], italics added.)

A. Strict Scrutiny Is The Proper Level Of Constitutional Review Of Section 2527

The Supreme Court of the United States held in *Sorrell* that the "First Amendment protects *even dry information, devoid of advocacy, political relevance, or artistic expression.*" (131 S.Ct. at pp. 2666–2667, italics added.) And heightened strict scrutiny, not some lesser form of constitutional review, applies to restrictions on such speech. (*Id.* at p. 2664.) Although, as defendants acknowledged (AOB35–36), this Court has not had occasion to address this precise question, the Supreme Court in *Sorrell* was unequivocal in so holding, as it had in *Riley* (see 487 U.S. at p. 788). Plaintiffs do not even cite *Sorrell* on this point. (See RB34.)

Plaintiffs do not dispute that content-based regulations are subject to strict scrutiny (AOB37; *Kasky*, *supra*, 27 Cal.4th at p. 952), that section 2527 is a content-based regulation (AOB37–38; *Sorrell*, *supra*, 131 S.Ct. at pp. 2662–2664), or that plaintiffs bear the burden of rebutting the presumption of invalidity (AOB37; *United States v. Playboy Entertainment Group, Inc.* (2000) 529 U.S. 803, 817). Plaintiffs suggest that section 2527 would survive both strict and intermediate scrutiny, but then attempt to defend the statute only under intermediate scrutiny. They do not mention (let alone apply)

the strict scrutiny standard. (RB46–51.) Rather, they claim that section 2527 is subject to lesser constitutional scrutiny because the content section 2527 compels defendants to publish is supposedly either 1) "commercial" or 2) "objective" and "factual." (RB49–52.) Plaintiffs are incorrect.[5]

1. The Speech Compelled By Section 2527 Is Not "Commercial" And Therefore Does Not Trigger Intermediate Scrutiny

Plaintiffs are incorrect that the court of appeal in *ARP* ignored *Kasky* or that *Kasky* supports plaintiffs' argument that the speech compelled by section 2527 is "commercial." *Kasky* holds, following a line of United States Supreme Court decisions, that in order to warrant lower constitutional scrutiny, "commercial speech" must consist of factual representations about the speaker or its products made for the purpose of engaging in commercial transactions. (*Kasky*, *supra*, 27

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[5] Plaintiffs' brief muddles significantly the standards and lines of cases for the various levels of constitutional scrutiny. The "commercial speech" doctrine applies to speech "about the business operations, products, or services of the speaker ... made for the purpose of promoting ... commercial transactions in[] the speaker's products or services," and results in intermediate scrutiny. (*Kasky*, *supra*, 27 Cal.4th at p. 962.) Lesser scrutiny may apply to commercial speech "reasonably related to the State's interest in preventing deception of consumers." (*Zauderer*, *supra*, 471 U.S. at p. 651.)

Cal.4th at p. 962; see also *Baba v. Bd. of Supervisors of City & County of S.F.* (2004) 124 Cal.App.4th 504, 514 ["'Commercial speech,' at its core, is speech that does 'no more than propose a commercial transaction', and, more broadly, is speech that goes beyond proposing such a transaction but yet 'relate[s] solely to the economic interests of the speaker and its audience'"].) *ARP* correctly applied *Kasky* and held that Section 2527's requirement that claims processors disclose reimbursement rates to third-party payors does not meet this standard. (*ARP*, *supra*, 138 Cal.App.4th at p. 1317, citing *Kasky*, at p. 960.) Specifically, *ARP* addressed the speaker (drug claims processor), the audience (insurers, health plans, and other drug benefit providers), and the content of the speech, concluding that "[n]othing about the content of this report proposes a commercial transaction between the speaker ... and its audience ... [n]or does it promote the processors' business ... [or] affect the economic interests of the required speakers." (*ARP*, at p. 1317.)

Kasky explained that when "commercial speech" is involved, the speaker "is likely to be someone engaged in commerce" communicating with "actual or potential buyers or customers of the speaker's goods or services ...." (*Kasky*, *supra*, 27 Cal.4th at p. 960.)

The communications are usually in advertising format and delivered in furtherance of *the speaker's* economic motivation. (*Id.* at p. 961.) Usually, "the speech consists of representations of fact about the business operations, products, or services *of the speaker* ... made for the purpose of promoting sales of, or other commercial transactions in, *the speaker's products or services*." (*Ibid.*) This is because the United States Supreme Court's commercial speech decisions "involved statements about a product or service, or about the operations or qualifications *of the person* offering the product or service." (*Ibid.*)

The fee studies compelled by section 2527 are not a form of advertising, and they do not identify any services offered by defendants or describe any benefits defendants provide. The speech is compelled by statute in order to aid third parties (the pharmacies) in their attempt to secure higher reimbursement rates, thereby *harming* the claims processors as well as pharmacy benefit plan sponsors such as employers. Indeed, plaintiffs admit that fee studies contain proprietary and confidential client information. (RB49–50.) The *only* motivation for the claims processors to make the disclosures is to

avoid liability for violations of section 2527. Plaintiffs do not allege otherwise.

Speech is not deemed "commercial" and subject to lesser scrutiny simply because defendants "have an economic interest" in *not* transmitting the content, as plaintiffs claim. (RB33–34.) That is not the standard articulated in *Kasky*. (See also *Commodity Trend Service, Inc. v. CFTC* (7th Cir. 1988) 149 F.3d 679, 684 ["speech does not become 'commercial' simply because it concerns economic subjects"].) Nor do the "ongoing and proposed transactions between third party payors and Appellants" render the disclosures required by section 2527 "commercial speech" (RB41), because the speech compelled does not relate to those transactions. (See *Brown v. Entertainment Merchants Assn.* (2011) 131 S.Ct. 2729; *Dex Media, supra*, 696 F.3d at p. 963 [Yellow Pages phonebook was not "commercial speech," even though it contained advertisements that resulted in commercial transactions].)

Kasky explained that "the category of commercial speech consists at its core of '"speech proposing a commercial transaction."'" (27 Cal.4th at p. 956, quoting *Central Hudson Gas & Electric Corp. v. Public Com. of N.Y.* (1980) 447 U.S. 559, 562 (*Central Hudson*).)

And, although some other decisions have broadened the definition of "commercial" speech somewhat, these decisions involve communications by a company to its customers about its products or services. (See *Kasky*, *supra*, 27 Cal.4th at p. 955 [collecting cases].) These speakers, *Kasky* explained, "act from a profit motive," and are therefore "less likely to experience a chilling effect from speech regulation." (*Id.* at p. 955.) Plaintiffs do not cite a single case in which speech has been deemed "commercial" when it was not engaged in for commercial purposes or in connection with a commercial transaction.

In contrast to *Kasky* and all the cases upon which plaintiffs rely, the speech compelled by section 2527 occurs *at the expense of the speaker (and the consuming public)*, and in fact forces the speaker to advocate against its own interests in the public debate over reimbursement rate regulation. (AOB37–39; pp. 20–21, *ante*.) The purpose for affording the legislature more latitude in regulating truly "commercial" speech is therefore inapplicable to section 2527.

2. Lesser Scrutiny Is Inappropriate Because Section 2527 Does Not Regulate Deceptive Advertising

Plaintiffs do not dispute that the line of cases allowing lesser scrutiny over speech regulations (see, e.g., *Zauderer*, *supra*, 471 U.S. at p. 651) applies only to laws requiring disclosures intended to correct false or misleading advertising (see RB44, fn. 9). Their claim that section 2527 is such a statute is based on pure hypothetical, untethered to the legislative history and the claims at issue in this case.

Zauderer by its terms applies to "disclosure requirements [that] are reasonably related to the State's interest in *preventing deception of consumers*." (471 U.S. at p. 651, italics added.) As defendants showed in the opening brief, the United States Supreme Court and many other courts have held expressly that the level of scrutiny articulated in *Zauderer* applies only to inherently or potentially deceptive advertising. (AOB49.) That is not alleged here (pp. 29–30, *post*), and none of the cases upon which plaintiffs rely supports application of rational basis scrutiny in this Court's review of section 2527.

In *Environmental Defense Center, Inc. v. United States Environmental Protection Agency* (9th Cir. 2003) 344 F.3d 832 (*Environmental Defense Center*), the basis for the Ninth Circuit's decision was that the compelled speech was part of a broad regulatory scheme (*id.* at pp. 848–850). The court relied on *Glickman v. Wileman Brothers & Elliot* (1997) 521 U.S. 457 in upholding the EPA's rule because the rule "constitutes a 'comprehensive program' restricting the autonomy of [operators] in the relevant arena of controlling toxic discharges to storm sewers to United States' waters." (*Environmental Defense Center*, at p. 850 & fn. 26.) Plaintiffs are correct that the Ninth Circuit in *Environmental Defense Center* relied on *Zauderer* (RB43, fn. 9), but only because, as in *Glickman*, "the purpose of the challenged provisions [was] legitimate and consistent with the regulatory goals of the overall scheme of the Clean Water Act." (*Environmental Defense Center*, at p. 849.)[6] The same is not true here—as plaintiffs do not dispute, and as the *en banc* Ninth Circuit specifically explained, section 2527 is a stand-alone regulation untethered to a broader regulatory scheme. (See AOB52; *Beeman III*,

[6] This was the core holding of the case and was not relegated to a footnote, as plaintiffs claim. (RB43, fn. 8.)

supra, 689 F.3d at p. 1009 ["section 2527 is not part of a regulatory scheme"; it "is a stand-alone law that does nothing more than mandate the content and transmission of speech"].)

In addition, the EPA regulation in *Environmental Defense Center* was not necessarily applicable to the objecting operators, whom the EPA gave two alternative means of complying. (*Environmental Defense Center*, *supra*, 344 F.3d at p. 848.) As a result, the court concluded that the "requirements d[id] not dictate a specific message." (*Id.* at p. 849.) However, section 2527 plainly dictates a specific message—it requires disclosure of "the results of a study ... which identifies the fees ... of all ... California pharmacies," as well as "an explanatory summary of the results and findings." (Civ. Code, § 2527, subd. (c).)

The First Circuit's decision in *PCMA* is similarly inapposite. Again, the disclosure requirements in that case were part of a broader comprehensive regulatory scheme. (*PCMA*, *supra*, 429 F.3d at p. 316.) And as the court of appeal in *ARP* noted in distinguishing the *PCMA* decision, section 2527 is not "aimed at eliminating possible unfair economic practices of drug claims processors by requiring them to disclose their own conflicts of interest and financial arrangements

with third parties," as was true of the Massachusetts statute. (*ARP*, *supra*, 138 Cal.App.4th at p. 1318.)[7]

All the other cases cited by plaintiffs involve safety-related disclosures, to which some courts have extended *Zauderer* scrutiny. (See, e.g., *Nat. Electrical Manufacturers Assn. v. Sorrell* (2d Cir. 2001) 272 F.3d 104, 115 [noting "Vermont's interest in protecting human health and the environment from mercury poisoning"]; *Scope Pictures of Mo., Inc. v. City of Kansas City* (8th Cir. 1998) 140 F.3d 1201, 1205 ["information about sexually transmitted diseases and unsafe sexual activities"].) These decisions limiting constitutional scrutiny over commercial regulations do not survive *Sorrell*, which expressly recognized "that the creation and dissemination of information are speech within the meaning of the First Amendment." (*Sorrell*, *supra*, 131 S.Ct. at p. 2667; see also *id.* at p. 2664 ["First Amendment requires heightened scrutiny whenever the government creates 'a regulation of speech because of disagreement with the message it conveys,'" and "[c]ommercial speech is no exception"].)

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[7] The First Circuit also was incorrect in rejecting the proposition that *Zauderer* is "limited to potentially deceptive advertising directed at consumers." (*PCMA*, *supra*, 429 F.3d at p. 310, fn. 8; see AOB49.)

But in either case, they have no bearing on section 2527, which does not require disclosure of anything related to consumer safety or welfare. (AOB51.)

Despite plaintiffs' repeated suggestions to the contrary (e.g., RB19, 50–51), there is no evidence in the legislative history that section 2527 was enacted to correct supposed misstatements or otherwise benefit consumers (ER163–164), nor do plaintiffs' claims in this case allege any misstatements by the defendants (see pp. 29–30, *post*). The uniform purpose of the bill was an attempt to pressure third-party payors into reimbursing pharmacists "according to the pharmacist's usual and customary charge," rather than "according to the Medi-Cal reimbursement." (ER146; see also *ARP*, *supra*, 138 Cal.App.4th at p. 1320 [purpose of bill "to encourage insurers to pay pharmacists a fair rate for drug dispensing services"].) In other words, the bill is intended to aid certain *businesses* (the pharmacists), not *consumers*. (*Id.* at p. 1319 [the "information required by section 2527 is not necessary to protect the public health or safety, or even the public fisc; it is not aimed at protecting consumers, or insurers, from being misled"].) Plaintiffs acknowledge this. (See, e.g., RB6 [California adopted section 2527 "in an effort to combat further

declines in the payments made to independent pharmacies for prescription medications"], RB9 ["Plaintiffs filed [this action] simply to require defendants to comply with their obligations under the law"].) As such, there is no basis for extending the standard used in cases of false advertising to the speech regulation here, which has nothing to do with protecting consumers.

Finally, plaintiffs attempt to distinguish *United States v. United Foods, Inc.* (2001) 533 U.S. 405 (*United Foods*) on the basis of the statement compelled, arguing that whereas the statement in *United Foods* was viewpoint-based, the speech compelled by section 2527 is not. (RB52.) This argument, however, completely misreads the Supreme Court's opinion. The Court in *United Foods* noted that "[w]e have not upheld compelled subsidies for speech in the context of a program where the principal object is speech itself." (533 U.S. at p. 415.) The reason the speech compelled was unconstitutional in *United Foods* but was upheld in *Glickman* was that in *Glickman* "mandated participation in an advertising program with a particular message was the logical concomitant of a valid scheme of economic regulation." (*Id.* at p. 412.) The role of the speech regulation in the context of "the entire regulatory program" (*ibid.*) is the key analysis

under *United Foods*, and for the unrebutted reasons stated in the opening brief, section 2527 is unconstitutional under that analysis. (AOB52–53.)

B. Defendants' Constitutional Challenge Can Be Adjudicated Now, Without Further Factual Development

Plaintiffs refer at several points to the "*potential* that the statistical information required by the statute is necessary to correct third[-]party payors' misimpressions." (RB17, italics added.) They claim that "the mere *possibility* of misstatements is a permissible basis to require counteracting disclosures." (*Ibid.*, original italics.) They do not claim that defendants have made any such misstatements, but they argue that because of the possibility of claims processors doing so, defendants' constitutional challenge is premature "at the pleading stage, without a developed factual record." (RB4.) But the factual development plaintiffs seek—proof that the disclosures required by section 2527 could aid in correcting hypothetical misstatements by claims processors—has no bearing on plaintiffs' claims in this case, and therefore would not affect the constitutional analysis.

Plaintiffs' complaint does not allege defendants made any misstatements or that the relief plaintiffs seek in forcing defendants to

transmit the fee studies would remedy any supposed "deception" by defendants. Rather, what is alleged is a technical violation of section 2527's reporting requirement. (See, e.g., ER153 ["Anthem has failed to conduct the studies required by California"], ER157 [defendant "WHP failed and refused to comply ... with the statutory requirements for conducting the statutorily required studies for the reasons detailed below"].) Indeed, plaintiffs' complaint recites the expressed intent of the legislature that by "requiring PBMs to supply [fee studies] to third-party payors, ... pharmacies would receive full reimbursement." (ER164.) And plaintiffs' attempt to defend the statute under intermediate scrutiny is centered not on the ability of the statute to correct misstatements, but on the supposed governmental interest in "optimal pharmacy reimbursements, as well as optimal consumer choice of and access to pharmacy health care." (RB47.) As a result, the question "whether or not Appellants and other PBMs have misled their clients" (RB19) is not at issue here and has no bearing on the constitutional analysis. (Cf. *Alvarez*, *supra*, 132 S.Ct. at p. 2545 [even admittedly false speech about military service is not immune from First Amendment scrutiny].)

Plaintiffs attempt to implicate the nonexistent misstatements and misimpressions by calling defendants' constitutional defense a "facial" challenge (RB14), but they are mistaken. Plaintiffs claim that defendants' arguments "are based on the text of the statute itself," and not "the manner by which the statute has been actually applied to them." (RB15.) Plaintiffs therefore argue that defendants must prove that the statute is unconstitutional in all, or at least the "great majority" of cases. (RB16.)

But defendants have maintained from the beginning that their challenge to the statute was as-applied—that they were not seeking total invalidation of section 2527, but rather to avoid the billion-dollar liability for the specific claims plaintiffs are pressing against them. (See, e.g., Appellants' Reply Brief (9th Cir. Dkt#47) at p. 11 ["Contrary to the Pharmacists' Argument, This Action Involves An 'As-Applied' Challenge To Section 2527's Constitutionality"].) Plaintiffs effectively concede throughout their brief that this case presents an as-applied challenge. (See, e.g., RB5 [criticizing defendants for raising their constitutional challenge "now, over 30 years after the statute went into effect *and only after they have been sued to enforce the statute*"], italics added.) The PBMs are, after all,

defendants in the case, and did not set out to strike down the statute on its face.[8]

A challenge based on the "text" of the statute is not necessarily a facial challenge; rather, a facial challenge is brought in order to invalidate a statute altogether, sometimes before the statute has been enacted or enforced. (See *Bowen v. Kendrick* (1988) 487 U.S. 589.) By contrast, where a defendant (as here) seeks to avoid application of the statute to its alleged conduct, such a challenge is as-applied, and the defendant need only prove that the statute is unconstitutional as applied to the defendant's conduct. (See, e.g., *Tobe v. City of Santa Ana* (1995) 9 Cal.4th 1069, 1084 ["An as applied challenge may seek ... relief from a specific application of a facially valid statute or ordinance to an individual or class of individuals who are under allegedly impermissible present restraint or disability as a result of the manner or circumstances in which the statute or ordinance has been

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[8] Plaintiffs' claim that defendants "do [not] challenge the manner by which the statute has been actually applied to them" (RB15) is therefore simply false. Moreover, plaintiffs' attempt to aggregate penalties under section 2527 and seek billions of dollars against defendants (AOB8–9, fn. 2; ER159, 167, 181, 189) raises other constitutional problems that would need to be addressed if the statute were upheld. (See, e.g., *Hale v. Morgan* (1978) 22 Cal.3d 388, 397–398.)

C. There Is No Basis For Plaintiffs' "Parade Of Horribles" That Would Supposedly Result From Invalidating Section 2527 As Applied Here

Plaintiffs claim that if section 2527 is subject to and fails strict scrutiny, then "nearly every law or regulation that requires a person or business to disclose any form of statistical, financial or other objectively truthful information would be subject to strict scrutiny review and unconstitutional." (RB3.) Without performing any constitutional analysis, plaintiffs simply posit that the "sky will fall" if section 2527 is invalidated. Plaintiffs are incorrect.

Section 2527 bears no relationship to the statutes plaintiffs use as examples, each of which requires disclosures related to public health (e.g., 21 U.S.C. § 343, subd. (q)(5)(H) [restaurants required to post calories of food items]; Cal. Pub. Resources Code, § 15013, subd. (b) [batteries must be labeled to prevent contamination]; Cal. Health & Saf. Code, § 111170 [warning regarding carcinogens]) or to prevent deception (e.g., Cal. Bus. & Prof. Code, § 17500 ["Made in the U.S.A." labels and pre-paid calling card disclosures]; Cal. Corp. Code, § 12310, subd. (b) [disclosure requirement in articles of incorporation]). By contrast, the "information required by section 2527 is not necessary to protect the public health or safety, or even the

applied"]; *Foti v. City of Menlo Park* (9th Cir. 1998) 146 F.3d 629, 635 ["An as-applied challenge contends that the law is unconstitutional as applied to the litigant's particular speech activity, even though the law may be capable of valid application to others"].)

Defendants are not required to prove that section 2527 is unconstitutional under any set of facts or allegations or that the statute could not be used against some claims processor who, as plaintiffs hypothesize, misleads third-party payors about the rates at which it is being reimbursed. Whether section 2527 would be constitutional in such a hypothetical case is not presented here, and there is therefore no need to develop a factual record on this point.[9]

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[9] Neither *Gerawan* nor *Buckley v. Valeo* (1976) 424 U.S. 1 imposes the *per se* requirement of a developed factual record that plaintiffs propose. (See RB14.) The opinions in both cases identify facts that *could* be developed in order to strengthen the First Amendment or free speech clause challenge, but neither case holds or suggests that such a challenge *cannot* be adjudicated on the pleadings. Indeed, this Court and other courts routinely have adjudicated First Amendment claims on the pleadings. (See, e.g., *Kasky*, *supra*, 27 Cal.4th at p. 962–963; *Blatty v. New York Times Co.*, *supra*, 42 Cal.3d at pp. 1048–1049 ["Since each of the causes of action, as we have concluded, was barred on First Amendment grounds specified in the demurrer, the sustaining of the demurrer was correct and as such must be upheld"]; see also *McDonald v. Smith* (1985) 472 U.S. 479, 481; *City of Alameda v. Premier Communications Network, Inc.* (1984) 156 Cal.App.3d 148.)

public fisc; it is not aimed at protecting consumers, or insurers, from being misled." (*ARP*, *supra*, 138 Cal.App.4th at p. 1318.) Rather, the purpose of section 2527 is "to encourage insurers to pay pharmacists a fair rate for drug dispensing services." (*Id.* at p. 1320.)

As a result, because all of plaintiffs' examples regulate commercial transactions with consumers (not other businesses) for the purpose of protecting consumers' health, safety, and ability to make informed purchasing decisions free from fraud or deception, the cited statutes may not trigger strict scrutiny. (See *ARP*, *supra*, 138 Cal.App.4th at p. 1318 ["Each of these examples involves the dissemination of information necessary for the protection of the general public. Section 2527 is not in that category."].) This is precisely why the Second Circuit upheld the New York statute against constitutional challenge. (See *N.Y. State Restaurant Assn. v. N.Y. City Bd. of Health* (2d Cir. 2009) 556 F.3d 114, 131 ["the form of speech affected by Regulation 81.50 is clearly commercial speech"].) In addition, the interests motivating the statute (e.g., toxin warnings) may be significant enough to survive a constitutional challenge. Nothing in plaintiffs' analysis suggests that all of these statutes would

be subject to or fail strict scrutiny if section 2527 is deemed to compel speech worthy of constitutional scrutiny.

III. Section 2527 Would Also Fail Intermediate Scrutiny

Section 2527 violates California's free speech clause even under the "intermediate scrutiny" applicable to commercial speech. Intermediate scrutiny requires that (1) there be a "substantial" government interest, (2) section 2527 directly advance that interest, (3) the regulation not be "more extensive than is necessary to serve that interest," and (4) there be a "'reasonable fit' between the government's purpose and the means chosen to achieve it." (*Kasky*, *supra*, 27 Cal.4th at p. 952, citing and quoting *Central Hudson*, *supra*, 447 U.S. 557.) Although, as discussed above, this standard is inapplicable here, plaintiffs are incorrect that section 2527 could survive even intermediate scrutiny.

Plaintiffs claim that the "substantial" government interest animating section 2527 is "to create a rational marketplace for pharmacy reimbursement rates," relying on *Central Hudson* and *Gerawan*. (RB47.) But these cases did not hold that assisting one group of market participants (pharmacists) in their attempt to negotiate higher reimbursement rates at the expense of other market

participants (such as claims processors and pharmacy benefit plan sponsors) is a substantial government interest. *Central Hudson* referred to an interest in constraining "higher overall rates" to "*consumers*" (447 U.S. at p. 569, italics added), not in manipulating the relative market share of different companies. The Court in *Gerawan* found substantial the "objective of maintaining and expanding markets for agricultural products, thereby ensuring the viability of California agriculture." (33 Cal.4th at p. 23.) But this objective has no relationship to the government's interest in section 2527, because the viability of the pharmaceutical market is not at issue.

Plaintiffs claim at one point that the legislature determined that the continued existence of community pharmacies was important to ensure that Californians in all areas of the State had access to medication. (RB7.) But there is no evidence in the legislative history that community pharmacies are on the brink of extinction. The portion of the record plaintiffs cite (ER148) says no such thing. Indeed, plaintiffs have persevered notwithstanding defendants' alleged decades-long noncompliance with section 2527.

Nor is there anything in the legislative history—or logic—supporting plaintiffs' claim that if third-party payors (such as insurance companies or employers that sponsor benefit plans) were informed of pharmacy reimbursement rates, and for some reason decided to require pharmacies to receive higher reimbursements (a dubious proposition, see pp. 39–40, *post*), this could somehow *reduce* health care costs for consumers. (See RB7.) It would almost certainly *raise* health care costs for third-party payors and, ultimately, the individuals covered by the third-party payors. (ER141–142 ["The goal of third-party administrators and payors ... is to keep costs as low as possible, a goal in direct conflict with that of the pharmacists"].) That is why the Department of Insurance opposed the initial bill. (See ER144 ["The end result of the bill, we think, [would] be to increase premiums to all insureds, with *pharmacies* being the ultimate beneficiaries. We think it is not in the best interest of the insurance-buying public."], italics added.) Plaintiffs claim that the insurance companies would "realize that cost savings would more likely be found in other areas of their business" (RB7), but this bizarre statement is as unsupported as it is implausible.

Plaintiffs offer no explanation as to why section 2527 "directly advances the governmental interest asserted," as *Central Hudson* requires. (447 U.S. at p. 566.) In fact, section 2527 on its face does not *directly* advance any purported interest because, as plaintiffs acknowledge, section 2527 does not require any action that could increase pharmacy reimbursement rates. (RB18 ["the proponent of the legislation stated that [section 2527] *might* cause insurers to reevaluate the ever-decreasing reimbursements they paid to pharmacies"; "*[h]owever, there was no requirement that they do so*"], italics added.) Plaintiffs claim that "the distribution of relevant information *has a connection* to determining and establishing fair rates and preserving consumer choice" (RB48, italics added), but that is not the standard articulated in *Central Hudson*, and any "connection" "is, at most, tenuous" (*Central Hudson*, *supra*, 447 U.S. at p. 569; see also *Sorrell*, *supra*, 131 S.Ct. at p. 2668 [the mark of a reasonable fit is one that "ensure[s] ... that the State's interests are proportional to their resulting burdens placed on speech"]). Plaintiffs cite nothing in the legislative history (and there is nothing), that suggests the required disclosures would actually lead to increased reimbursement rates. Indeed, the report to the Assembly Committee

on Finance, Insurance, and Commerce explained that the disclosures were premised on only a "*hope* that *at a time in the future* this information will become the basis for reimbursement." (ER146, italics added.)

Finally, plaintiffs do not show that section 2527 is "not more extensive than is necessary to serve" the legislature's supposed "interest," as *Kasky* requires. (*Kasky*, *supra*, 27 Cal.4th at p. 952.) There is no basis for plaintiffs' claim they would be barred by antitrust laws from disseminating the rates at which they are being reimbursed. The case they cite (*Northern Cal. Pharmaceutical Assn. v. United States* (9th Cir. 1962) 306 F.2d 379) involved a criminal conviction for fixing prices (*id.* at p. 381). And nothing in the opinion suggests that gathering and disseminating data would violate the federal antitrust laws. Plaintiffs claim that only defendants know who their clients are, and therefore "only they can convey the required information to those clients." (RB50.) That claim ignores the fact that, if they wished, pharmacies could publish the studies to all managed care organizations, insurers, and major employers without knowing which of those plan sponsors is a client of which claims processor. (See AOB48.) In other words, the pharmacies could

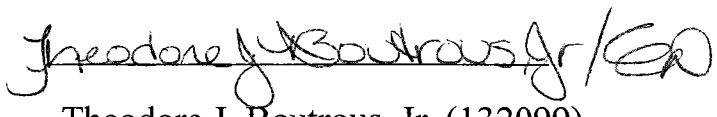
effectively disseminate the dispensing fee information without any involvement on the part of defendants.

Plaintiffs again attempt to raise factual questions they claim warrant discovery and development of a record (RB50), but their attempt to do so misapprehends the constitutional problem with section 2527. The statute is not unconstitutional because the fee studies it compels would conflict with other data about reimbursement rates that defendants send to their clients. There is no basis in either the legislative history or plaintiffs' allegations for concluding that defendants have misled their clients. Rather, section 2527 is unconstitutional because it compels claims processors to transmit fee studies that are against the claims processors' interest—because pharmacies wish to use the studies in negotiation over reimbursement rates and in the public debate over reimbursement rate regulation. That pharmacies intend to use the fee studies for this purpose is apparent from the legislative history and the record. (See AOB12.)

CONCLUSION

Section 2527 compels speech in violation of article I, section 2 of the California Constitution. This Court should therefore answer the Ninth Circuit's certified question in the affirmative.

Dated: February 4, 2013 Respectfully submitted,



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CERTIFICATE OF WORD COUNT

Pursuant to California Rule of Court 8.204, subdivision (c), I hereby certify that this brief contains 8,314 words, including footnotes, excluding those portions as permitted under Rule 8.520 subdivision (c)(1). I have relied on the word count of the computer program used to prepare the brief.

Dated: February 4, 2013

Blaine H. Evanson

PROOF OF SERVICE

I, Laura Rocha Maez, declare, I am a citizen of the United States, a resident of Los Angeles County, and over 18 years of age. I am not a party to this action. My business address is Gibson, Dunn & Crutcher LLP, 333 South Grand Ave, Los Angeles, CA 90071-3197.

On February 4, 2013, I served a copy of **APPELLANTS' CONSOLIDATED REPLY BRIEF** in this action by placing a true and correct copy thereof, enclosed in a sealed envelope with postage fully prepaid, in the United States Mail on the following interested parties in this action:

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I declare, under penalty of perjury, that the foregoing is true and correct.

Dated: February 4, 2013

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