Legal Opinion Letter

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# STATE DRUG AD "REBATE" PROPOSAL TREADS ON COMMERCIAL SPEECH RIGHTS

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Lawmakers in California soon will take up an unprecedented proposal to impose, in effect, a special tax on advertisements for prescription drugs that help many of the state's most seriously ill residents. Assembly Bill 95 would require manufacturers of drugs for "life-threatening chronic conditions" to disclose marketing costs and then pay the state a "rebate" equal to those costs if the pharmaceuticals are covered by one of two state subsidy programs. Proponents claim that the measure would reduce California's costs for its Medi-Cal and AIDS Drugs Assistance Program, apparently based on the theory that marketing efforts, including so-called "direct to consumer" ("DTC") advertising, inflate the per-prescription price of drugs.

Policymakers considering A.B. 95 or any similar proposals should understand that such rebate schemes cannot escape First Amendment scrutiny merely because they do not explicitly ban speech. The proposed California rebate would substantially burden drug manufacturers' ability to deliver critical, truthful information about their products to patients and physicians. Under recent Supreme Court precedent, even indirect burdens on commercial speech are suspect. Moreover, the measure appears unlikely to hold down the state's drug-subsidy expenditures—unless the real goal is to cap the total subsidy costs by depriving some eligible patients of truthful information about drugs that could treat their conditions.

Details of Proposed Legislation. A.B. 95's key provision would require drug manufacturers on the state subsidy list to pay California a rebate equal to the "costs of marketing" the pharmaceuticals. The bill defines "marketing" expansively to include "any cost associated with direct-to-consumer advertising" and most cash payments or gifts to physicians that are "not directly related to the benefit of the patient" or associated with legitimate physician education. The size of the rebate would depend upon whether the manufacturer complies with the bill's mandate to disclose "all costs" incurred in marketing the drug to consumers and physicians. A manufacturer complying with the disclosure obligation would get a tax break of sorts: the rebate would only amount to 90 percent of its marketing costs. Manufacturers not complying with the disclosure mandate would face a stiff tax in exercising their speech rights: the rebate would be set at 25 percent of the federal Public Health Service ("PHS") price of the drug.

Implications. A.B. 95 represents an ill-advised effort to use speech suppression as a means of controlling state subsidy costs. Although the proposed rebate scheme does not explicitly ban DTC advertising and other marketing, the bill presents drug makers with a stark choice. They may either advertise their products and pay a monetary penalty for doing so, or avoid the monetary penalty by staying silent.

Taxes imposed on the privilege of speaking have raised alarms since the days of the Founders, and modern courts have not hesitated to strike down taxing schemes that impose heavier burdens on some messages than others. See, e.g., Ark. Writers' Project v. Ragland, 481 U.S. 221 (1987). Yet even if A.B. 95 is not construed as a direct tax on drug advertising, its oppressive effect is the same. The Supreme Court has made plain that "[w]hat the First Amendment precludes the government from commanding directly, it also

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precludes the government from accomplishing indirectly." Rutan v. Republican Party, 497 U.S. 62, 77-8 (1990). More recently, the Court has ended any confusion as to whether the "indirect burdens" analysis also applies to commercial speech. In Thompson v. Western States Medical Center, 535 U.S. 357 (2002), the Court struck down a federal statute that indirectly limited pharmacists' ability to advertise truthful information about specific "compounded" drugs (i.e., tailor-made pharmaceuticals mixed to a doctor's specific directions). Although the indirect burdens analysis was not a focal point of Western States, both the majority and minority in the case recognized the First Amendment issues—thereby implicitly acknowledging that indirect burdens are reviewable in commercial speech cases.

Under the well-established test for evaluating commercial speech restraints, set forth in Central Hudson Gas & Electric Corp. v. Public Service Comm'n, 447 U.S. 557 (1980) and its progeny, the government's ability to control advertising is quite limited. As long as the commercial message is truthful and not misleading, the government faces serious evidentiary burdens in justifying regulation of it: the restraint must (1) serve a "substantial" goal, (2) "directly advance" that goal, and (3) be "narrowly tailored" to meet the purpose so as to avoid unnecessary speech suppression.

A.B. 95 does not purport to challenge the veracity of drug advertising; it merely addresses purported costs that affect the state's drug subsidy programs. Thus, in defending the rebate scheme against constitutional challenge, California would have to show that not only is its goal of controlling state subsidy costs legitimate but that the rebate mechanism actually works—and does so in a way that seeks to avoid burdening protected speech.

Even assuming arguendo that A.B 95's goal is sufficiently substantial, California will be hard-pressed to satisfy the remaining prongs of Central Hudson. With respect to "direct advancement," the bill rests on the likely fatal assumption that advertising necessarily hikes the per-unit price of drugs for individual patients. But recent economic studies suggest that there is no clear correlation between advertising dollars and per-unit prices. Furthermore, existing literature indicates market expansion through informative advertising actually may reduce unit costs by increasing production and, as a result, spread advertising expenses over a larger base. Therefore, unless state lawmakers muster facts to show a link between suppression of advertising and reduced per-unit costs, A.B. 95 likely would be struck down on this prong.

The state's only alternative argument on this point might be to characterize the rebate mechanism as serving to lower aggregate drug expenditures by reducing the number of patients seeking subsidized treatment. But advancing a goal by keeping at least some eligible beneficiaries ignorant is hardly an attractive policy choice. It also would resurrect a serious issue under Central Hudson: asserting that the state has a "substantial" interest in restricting information about effective drug treatments would appear to contradict the health care foundation of the subsidy programs.

Finally, even if A.B. 95 survived the initial prong of Central Hudson, it would surely founder on the last one: the rebate scheme plainly is more extensive than necessary to reduce California's drug subsidy costs. The state has numerous non-speech alternatives that would serve its purpose, including changes in eligibility standards, caps on coverage during a given period or any combination of these or other factors. The Court in Western States directly admonished lawmakers on this point: "If the First Amendment means anything, it means that regulating speech must be a last—not first—resort. Yet here it seems to have been the first strategy the Government thought to try."

Conclusion. A.B. 95's mandatory rebate scheme would penalize manufacturers and California consumers alike. While the rebate's taxing mechanism obviously burdens drug manufacturers' commercial speech rights, another effect—due to the likely curtailing of DTC advertising—would be to cut off the flow of critical treatment information to patients and their physicians.

A hearing on A.B. 95 is presently scheduled for April 12, 2005 before the state assembly's Committee of Health.

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