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Supreme Court Review of the Affordable Care Act: Implications for Plan Sponsors and Health Insurers

In March, the United States Supreme Court heard three days of oral arguments concerning the constitutional challenges to the federal health care reform law, known as the Patient Protection and Affordable Care Act (the "ACA"). (For a detailed discussion of the oral arguments, see our client alert which is available at http://www.groom.com/resources-661.html). The proceedings generated an extraordinary amount of press coverage and a great deal of speculation concerning possible rulings from the Court. The Justices attended a confidential conference on March 30th to vote on the outcome of the challenges to the ACA, after which drafting responsibility for the written decision was assigned. It is expected that the Court will issue its written decision at the end of its current term, near the end of June 2012, although there is some speculation that the decision could be issued before then.

As we approach the time for a decision, we wanted to highlight some potential outcomes of the Court's ruling, to help prepare employers and insurers for operational or business changes that may be required.

I. Background

The Supreme Court is considering two constitutional challenges to the ACA: *First*, did Congress exceed its power to regulate interstate commerce when it enacted the ACA's so-called "individual mandate," which requires virtually all Americans to have health insurance in 2014, or pay a penalty on their income taxes? *Second*, did Congress impermissibly "coerce" states by requiring that the states, beginning in 2014, expand eligibility for their Medicaid programs to 133 percent of the Federal Poverty Level as a condition for receiving federal Medicaid funding? [1]

A critical issue related to the constitutional challenges is whether other parts of the ACA are "severable" from the individual mandate or Medicaid expansion, should the Court rule that either provision is unconstitutional. In other words, what parts of the ACA – if any – will survive if the Court strikes down either the individual mandate or the Medicaid expansion?[2]

Although we are not predicting how the Supreme Court will rule, employers and insurers should be aware of how the Court *could* rule, and the implications that may follow the Court's ruling. We provide a high-level overview of possible rulings – and their potential implications – below.

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[1] The Court will also consider whether the constitutional challenges to the individual mandate are premature. Specifically, if the Court finds that the penalty assessed for failing to carry insurance beginning in 2014 is actually a tax (as the Fourth Circuit Court of Appeals found), it could conclude that a 19th Century law known as the Anti-Injunction Act prohibits federal courts from hearing challenges to the tax before it is actually assessed, which would not be until 2015. Based on questions asked during oral argument, however, it seems likely the Court will find that the Anti-Injunction Act is not applicable, thus allowing the Court to consider the merits of the constitutional challenges.

[2] We note that the Court's focus on this "severability" issue related primarily to the individual mandate. Accordingly, we do not address the issue of Medicaid expansion in detail in this article.

II. Potential Outcomes

A. ACA Upheld In Its Entirety

One potential outcome that was somewhat lost in media coverage of the oral arguments is that the Court may *uphold* the individual mandate as a permissible exercise of Congress's authority to regulate interstate commerce (or, alternatively, as a permissible exercise of Congress's taxing power), and reject the argument that the Medicaid expansion is impermissibly coercive. Put simply, a majority of the Court could reject the constitutional challenges to the ACA, in which case the ACA will continue to be the law of the land.

It is difficult to predict how likely this outcome is, and it is widely speculated that the outcome may be determined by Justice Kennedy, who is thought to be the likely swing vote. During oral argument, Justice Kennedy expressed skepticism as to whether the individual mandate is constitutional, stating that the mandate "changes the relationship of the government to the individual in a fundamental way," and suggested that there is a "very heavy burden of justification" to show where the Constitution authorizes Congress to change the relation of the individual to the government. He later suggested, however, that the health insurance market may be unique enough to justify such a novel regulation of individual economic behavior.

B. Individual Mandate Struck Down, But Remainder of the ACA Is Upheld

Another potential outcome is that the Court may find the individual mandate unconstitutional, but rule that it is entirely severable from the remainder of the ACA – meaning that all other aspects of the ACA (including the employer "pay-or-play" provisions, the Exchanges, and revenue raisers) will go into effect.

During oral argument, the Court appeared to struggle with how much of the ACA, if any, could survive if the individual mandate is ruled unconstitutional. Although it is possible that the Court could find the individual mandate entirely severable from the ACA, a majority of Justices appeared skeptical of this argument, noting (as discussed below) that the individual mandate is closely tied to the ACA's guaranteed issue and community rating rules which are applicable to insurers beginning in 2014.

C. Individual Mandate, Guaranteed Issue and Community Rating Rules Struck Down

The Court could also find that if the individual mandate is unconstitutional, then other provisions that are directly "intertwined" with the mandate – such as the ACA's guaranteed issue and community rating rules – should also be struck down. All other provisions of the ACA, however, would remain in effect.

During oral argument, it seemed that a majority of the Court was concerned that that striking down the individual mandate without also striking the ACA's guaranteed issue and community rating rules would expose insurers to risks that Congress did not contemplate. In this regard, the Administration agreed that if the individual mandate is struck down, then so too should the guaranteed issue and community rating rules – but all other provisions of the ACA should still be in effect.

It is also possible that the Court could determine that other provisions of the ACA – especially those in Title I which address the key insurance market reforms scheduled to take effect in 2014 (such as the Exchanges and tax subsidies) – are so closely related to the individual mandate that Congress would not have enacted those provisions in the absence of the mandate. If that is the case, then the Court could also strike down those provisions. The extent to which the Court strikes any provision of the ACA – and the actual language the Court uses – will be critical in assessing the extent and impact of the Court's ruling, given that many ACA provisions are expressly cross-referenced in other provisions, meaning that the Court's invalidation of one provision could, perhaps, impact another provision that was not expressly addressed by the Court's ruling.

D. Individual Mandate Struck Down, And Case Remanded to Lower Court or Special Master to Determine Which of the Remaining ACA Provisions Survive

Another possible outcome is that the Court could find that the individual mandate is unconstitutional, but not address what other provisions of the ACA should also be struck down. Instead, the Court could remand the case back to the 11th Circuit Court of Appeals or a special master with instructions for that entity to determine which of the remaining ACA provisions will survive the Court's ruling.

As discussed further below, such an outcome would cause considerable uncertainty for employers and insurers who will need to tailor their business operations and legal obligations to the ACA's requirements prior to the lower court or special master's ruling – and the inevitable appeals that will follow. Indeed, prior to a final decision on severability, we would expect the Administration to argue that any portions of the ACA that were not expressly invalidated remain in full force and effect.

E. The Entirety of the ACA Is Struck Down

The Court also could decide that the individual mandate is so integral to the functioning of the ACA that the entirety of the law should be struck down if the individual mandate is unconstitutional. This position was advanced by a number of states and private parties.

At oral argument, four Justices (Kagan, Breyer, Ginsburg and Sotomayor) expressed skepticism that the ACA should be invalidated as a whole if the individual mandate is ruled unconstitutional. Justices Kennedy, Scalia, Alito and Chief Justice Roberts, however, asked questions that suggested they were considering whether *any* provision of the ACA could survive without the individual mandate.

III. Potential Impact of the Supreme Court's Ruling

A. Plan Sponsors

If the Court upholds the ACA in its entirety, there will be no impact on ACA implementation for employers. In that case, employers and other plan sponsors will be required to continue with their efforts to implement the myriad of ACA reforms, and will be subject to other applicable provisions, including the ACA's "pay-or-play" provision that is applicable to employers with 50 or more full time employees (commonly referred to as the "employer mandate").

If the individual mandate is ruled unconstitutional but all of the ACA's remaining requirements are permitted to go into effect, the ruling will likely have minimal impact on an employer's obligation to comply with the ACA, given that

other key provisions of the ACA will remain in effect – including rules related to age 26 dependent coverage, lifetime and annual limits, external appeals, summary of benefit coverage disclosures, and preventive care. Additionally, key structural reforms to the health care industry will continue, including the implementation of the employer mandate and state-based Exchanges, not to mention the host of revenue raisers that will apply to plan sponsors and other key players in the health care industry. We note, however, that in the absence of an individual mandate, healthier employees may have an increased incentive to decline employer-sponsored coverage because upon becoming ill, they will be able to obtain guaranteed issue individual coverage through an Exchange, which will serve as a coverage "bridge" until such time as they are eligible to enroll in the employer's plan during an open enrollment period.

If the Court strikes down the individual mandate along with just the ACA's guaranteed issue and community rating rules, it is likely that such a ruling will have little impact on employers that sponsor health plans, inasmuch as all other provisions of the ACA that are directly applicable to group health plans will go into effect as scheduled, and given that the individual mandate is applicable only to individuals, and that the guaranteed issue and community rating rules only apply to insurers.

Employers will face significant difficulties, however, if the Court strikes down the individual mandate and remands the case to a lower court or special master to determine what other parts of the ACA should be stricken. Specifically, employers will face considerable challenges as they attempt to design their benefit plans for the upcoming 2013 plan year, given that it may be unclear whether specific ACA provisions will survive the severability proceedings – and given the Administration's likely position that any provisions not expressly stuck down by the Supreme Court remain in effect. This could especially be the case if there is no majority opinion as to the extent of severability, or if the Court issues a majority opinion that is ambiguous or unclear as to the scope of provisions that are to be invalidated. In any event, if the Court chooses this path, it is likely that employers' near-term ACA implementation and compliance efforts will need to continue.

Finally, if the entirety of the ACA is struck down, plan sponsors will have to make careful choices about whether they want to reverse plan changes that were implemented due to the ACA's requirements. Specifically:

- If a self-funded group health plan has been amended to comply with ACA reforms that have already gone into effect – such as the rules involving age 26 dependent coverage, lifetime and annual limits, external review, and preventive care without cost-sharing – the plan sponsor must decide whether it wants to amend the plan (or any applicable contract with a third party administrator) to reverse these changes. This will involve not only consideration of the costs of these ACA rules, but also consideration of employee reaction should the employer decide to reverse changes made because of the ACA (especially discontinuance of dependent coverage up to age 26).

    - In the absence of a plan amendment reversing changes made because of the ACA, the plan will have to continue to be administered as written, even if the ACA is struck down. Accordingly, plan sponsors should carefully review their third party administration agreements, plan documents, summary plan descriptions, and other communications and procedures to see what amendments may be required (and what impact, if any, such amendments may have on fees that the plan pays to third party administrators).

- Additionally, plan sponsors should be aware that many states have adopted some or all of the ACA's insurance market reforms (such as the age 26 dependent coverage rules and prohibitions on lifetime and annual limits) as part of state insurance law. Accordingly, any group insurance policy that an employer may purchase (such as HMO coverage) may still be required to comply with such reforms as a matter of state law, even if the ACA is struck down as federal law. (This issue is discussed further below).

- With respect to ACA reforms that are scheduled to go into effect in the future (*e.g.*, the summary of benefit coverage disclosures, the $2,500 limitation on salary reduction contributions to a health FSA, 90-day limit on waiting periods, etc.), such reforms generally will not apply, meaning that plans will not have to come into compliance with those provisions unless the plan sponsor elects to do so.

- Plans should be aware that they may need to communicate any plan changes made in response to the Supreme Court's ruling to participants. ERISA requires a group health plan to provide a summary of material modification ("SMM") where there is material reduction in covered health benefits within 60 days of adoption. A "material reduction" means any modification that, independently or in conjunction with other changes, would be considered by an average plan participant to be an important reduction in covered services or benefits. For example, if a plan decides to drop the age 26 dependent coverage rule because that provision of the ACA was struck down, and instead reverts back to its original design of only covering dependents who are full-time students, the plan likely would need to send an SMM to plan participants within 60 days of adopting the amendment. Plans will need to decide the best timing to adopt changes and the avenue to deliver these types of notices.

B. Health Insurers

If the ACA is upheld in its entirety, there will be little or no impact on insurers' existing ACA compliance and implementation efforts, in that all ACA-imposed changes to the insurance industry and its products will continue in effect.

If, however, the individual mandate is ruled unconstitutional, but *only* that provision is struck down, this could present serious problems for both insurers and consumers, given the risk of adverse selection as younger, healthier people may avoid buying insurance until they get sick. This, in turn, could cause premiums to spiral upwards and become unaffordable for many employers and individuals (the so-called insurance "death spiral"). To mitigate this risk, the Administration argued that the individual mandate is inextricably tied to the ACA's guaranteed issue and community rating provisions. It appears that the Court may be sympathetic to this argument. If so, the problems that insurers and consumers would face if only the individual mandate is struck down may be mitigated.

If the Court decides to strike down the individual mandate and remand the case to the lower court or a special master to determine the extent of severability, insurers will face problems similar to employers, in that they will be required to offer products that contain provisions that may or may not survive court review, and will be forced to design – and appropriately price – policies for the upcoming plan year that contain ACA-compliant benefits that may eventually be invalidated by the reviewing court. And given the likelihood that any severability ruling reached by the reviewing court will be appealed, insurers could face such uncertainty for an extended period of time. In the near term, however, insurers likely would have to continue their ACA compliance and implementation efforts.

It is critical to note that even if the ACA is struck down in its entirety, the ACA's insurance market reforms may nonetheless still be applicable to insurers as a matter of state law. Specifically:

- Insurers may be unable to immediately reverse or discontinue changes made because of the ACA, given that the policies they have issued provide for such benefits, and may be enforceable as a matter of contract. Moreover, it may not be possible to modify or amend policy forms that have been filed with and approved by state insurance regulators (unless the insurance commissioner so approves).

- Additionally, many states have adopted some or all of the ACA's insurance market reforms as part of state insurance law, meaning that such provisions are applicable to insurers under state law regardless of whether they are enforceable under federal law.

- Accordingly, insurers will have to do a state-by-state analysis of applicable state laws to determine whether the states in which they operate have adopted some or all of the ACA's insurance market reforms.

    - If a state has simply adopted the federal ACA provisions by reference, it may be possible to argue that the state's law became invalid at the same time, and to the same extent, as the federal ACA provisions.

    - If, however, a state restated ACA provisions in the state's legal code, then the state's version of the applicable ACA provisions may be deemed to exist independently of the federal law, and may continue to apply to insurers in that state despite the invalidation of the ACA. However, the state may have a sunset provision or a provision tying the applicability of the state reforms to the constitutionality of the federal ACA, which could potentially result in the invalidation of the state law.

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Whatever its outcome, the Supreme Court's ruling on the constitutionality of the ACA will be historic, and it will require careful analysis by employers and insurers as to its implications. Groom Law Group will hold a webinar discussing the Supreme Court's ruling – and its implications for insurers and plan sponsors – within a few days of the written decision. We will announce the date and time of the webinar as soon as the written decision is issued.