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Supreme Court Hears Arguments On Availability of ACA Tax Subsidies Through Federal Exchanges

The U.S. Supreme Court just heard oral arguments on yet another landmark case involving the Affordable Care Act (the "ACA"), this time addressing one of the key features of the law: the availability of tax credits to subsidize the cost of health insurance coverage for low-income individuals who purchase coverage through a federally-established Exchange. The outcome of the case, called *King v. Burwell*, will have significant impact on many, including (1) health insurers, to whom the subsidies are ultimately paid, (2) employers, given that the ACA's "employer mandate" penalty is only triggered if a full-time employee receives a federal tax credit, and (3) individuals that may lose their ability to access federal subsidies. If the Court rules that tax credits are *not* available for coverage obtained through a federal Exchange, it could be a potentially devastating blow to the viability of the ACA, given that the majority of states have declined to establish Exchanges.

Background

A. ACA Provisions Concerning Payment of Tax Credits

Section 1311 of the ACA provides that individuals can purchase health insurance on American Health Benefit Exchanges ("Exchanges"). Under the ACA, Exchanges may be established by either individual states or the federal government. Congress expected most states to establish their own Exchanges and provided financial assistance to enable states to do so. But Congress also realized that some states might refuse to establish their own Exchanges. For that reason, Section 1321(c) of the ACA provides that if a state declines to establish its own Exchange, the federal Department of Health and Human Services ("HHS") "shall establish and operate such Exchange within the State[.]"

The ACA also authorizes a federal tax credit for low- and middle-income individuals who purchase insurance through an Exchange "established by a State." Specifically, the ACA added Section 36B to the Internal Revenue Code (the "Code"), which provides that tax credits are available to otherwise qualifying individuals who "were enrolled in [coverage] through an Exchange *established by the State* under [section] 1311 of the [ACA]." (Emphasis added). This italicized language raised the question of whether tax subsidies would be available only for coverage that was purchased through a state-established Exchange, and preclude the payment of subsidies for coverage obtained through a federally-established Exchange. This question became even more critical last year once the Exchanges began operating, given that only 16 states plus the District of Columbia established their own Exchanges.

The Internal Revenue Service ("IRS") issued a regulation interpreting Code Section 36B to allow for the payment of tax credits to all financially eligible Americans, regardless of whether they purchased coverage through a state or federal Exchange. In reaching this conclusion, the IRS took the view that the ACA's mandate that HHS "establish *such* Exchange" when a state declines to do so essentially placed HHS in the shoes of the state, thus allowing for the payment of tax credits to otherwise qualifying individuals who obtained coverage through a federally established Exchange.

B. Federal Courts Disagreed on the Meaning of the ACA Provisions

A number of lawsuits were filed challenging the IRS's interpretation. The plaintiffs in *King* filed a lawsuit in the Eastern District of Virginia, arguing that the IRS's interpretation was contrary to Code Section 36B, which limits the availability of tax credits to only coverage obtained through an Exchange "established *by a State*." Because a federal Exchange is not "established by a State," the plaintiffs argued, the plain language of the Code Section 36B prohibited the payment of tax credits for coverage obtained through a federal Exchange. Additionally, the plaintiffs argued that the purpose of the tax credit was to induce states to set up their own Exchanges, by providing that the credit would not be available if the federal government had to operate the Exchange. The district court in *King* rejected the plaintiffs' arguments and granted the government's motion to dismiss the case.

A similar lawsuit, *Halbig v. Burwell*, was filed in the federal court of the District of Columbia. And like the district court in *King*, the DC-based district court ruled in favor of the government, finding that its interpretation of Code Section 36B was reasonable given ambiguities in the statutory language. Several similar cases are pending in other courts across the country.

On July 22, 2014, the Fourth Circuit Court of Appeals upheld the district court's ruling in *King v. Burwell.* In so doing, the appellate court upheld the IRS regulation providing that federal subsidies are available to individuals purchasing health insurance through the federal Exchanges. The Fourth Circuit found that the IRS's interpretation was "permissible exercise of the agency's discretion." But on the same day, a contrary decision was issued by the Court of Appeals for the DC Circuit in *Halbig v. Burwell*. In a 2-1 ruling, the DC Circuit found that the IRS's interpretation was contrary to the plain language of Code Section 36B, and that the agency's interpretation was therefore impermissible.

The Supreme Court agreed to hear the plaintiffs' appeal in the *King* case. It is important to note that unlike the Supreme Court's 2012 decision in *National Federation of Independent Business v. Sebelius* – which addressed whether the ACA's "individual mandate" was constitutional (and which, in turn, could have resulted in the invalidation of the ACA entirely) – the *King* case involves a matter of statutory interpretation that technically impacts only one provision of the ACA, *i.e.*, whether Code Section 36B's reference to Exchanges "established by a State" precludes payment of subsidies for coverage obtained through a federally-established Exchange. But as discussed below, the Court's decision in *King* will have significant consequences for health insurers and employers, as well as individuals who live in the 34 states where the federal government operates Exchanges in lieu of the respective states.

Below, we summarize the Supreme Court oral argument and offer some thoughts as to its implications for insurers and employers. It is important to note that it is not possible to predict the outcome of a Supreme Court case based on the questions asked during oral argument, although oral argument provides insight as to issues that are of particular concern to the Court.

March 4, 2015 Oral Argument

A. The Petitioner's Argument

The petitioners in *King* – who are seeking to prevent the IRS from providing subsidies to individuals enrolling in coverage through federally-run Exchanges – opened by focusing heavily on the text of Code Section 36B, which they argue only provides subsidies for coverage purchased on an Exchange "established by a State." As expected, this argument faced aggressive questions from what is commonly characterized as the Court's "liberal" wing, which includes Justices Ginsburg, Breyer, Sotomayor and Kagan. Many of the questions from these Justices focused on the importance of reading the words of a statute in context with other provisions of the law – and the purposes for which the law was enacted – rather than just focusing on specific words read in isolation.

During oral argument, Justice Breyer stated that ACA Section 1321 provides that if a state does not establish an Exchange, then HHS is directed to "Establish and operate *such* Exchange," indicating that Congress equated a federally-established Exchange with a state-Exchange. Justice Kagan picked up on this line of questioning, suggesting that Section 1321 simply created a fallback mechanism by which an Exchange would be established in every state, with Congress being "agnostic" as to the entity that actually ran the Exchange.

As the petitioners' argument progressed, Justices Kagan, Breyer, Sotomayor, and Kennedy all expressed doubts that the ACA would reasonably function as intended if the petitioners' reading of the statute was accepted. Justice Sotomayor suggested that reading the statute to deprive citizens of states that do not establish their own Exchanges of federal subsidies impermissibly coerced states, since their insurance markets would experience a "death spiral" in the absence of subsidies. And importantly, Justice Kennedy – who is frequently a "swing" vote – expressed concern that under petitioners' reading, the federal government would all but force states to create their own Exchanges, by not only withholding tax credits to citizens of refusing states, but by also putting the insurance markets in such states at risk of failure should the ACA's subsidy/individual mandate system not operate in that particular state. Justice Kennedy expressed the view that this could amount to impermissible federal coercion of states, and thus was a "serious constitutional problem." We note that this line of argument is similar to the argument that persuaded the Supreme Court to hold that the ACA's Medicaid expansion had to be voluntary, rather than mandatory, as Congress initially intended.

B. The Government's Argument

The U.S. Government opened its argument by discussing whether the petitioners even had standing to challenge the IRS ruling, but other than Justice Ginsburg, this didn't attract much attention, with the remainder of the Justices seeming anxious to get to the merits of the case. The Solicitor General (who represents the U.S. before the Supreme Court) first argued that the IRS's interpretation – which makes subsidies available on Exchanges created by both the states and HHS – gives meaning to all the words of the related ACA provisions at issue. He then argued that the IRS's interpretation was compelled by both the structure and design of the ACA, given that the ACA expressly provides states with flexibility regarding the establishment of Exchanges while also having the goal of making affordable coverage available to all Americans. According to the government, the petitioners' reading of Code Section 36B would directly undermine Congress's goal in enacting the ACA and thus, Congress could not have enacted Code Section 36B to read in such a manner.

Justice Scalia responded that "of course" Congress could have enacted a statute that functions the way petitioners argue, noting that statutes can be written in a less-than-optimal manner, but that a Court's job was to interpret what Congress wrote rather to focus on preferred policy outcomes. Justice Alito noted that that Congress and the states could promptly address a Court ruling that rejected the IRS's interpretation, and suggested that the Court could even defer the effective date of its decision to allow time for lawmakers to respond to the ruling.

The Solicitor General then argued that if the Court determined that there was an ambiguity with respect to the availability of subsidies for coverage obtained through a federally-established Exchange – which the government did not think was the case – the IRS's interpretation would be entitled to deference under the Supreme Court's decision in *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Surprisingly, none of the Justices engaged in a substantive discussion as to the degree to which *Chevron* deference may apply in this case.

Notably, Chief Justice Roberts – who cast the deciding vote upholding the constitutionality of the individual mandate three years ago – did not ask questions of either side that suggested how he views the merits of the case.

Implications of the *King* Case

The *King* case involves more than the legal issue of the degree of deference that courts should afford to administrative agencies when interpreting the words used in a statute. The Court's decision in *King* will have real consequences for insurers, employers and millions of people. The federal government has established Exchanges in 34 states, and current estimates indicate that close to seven million people have obtained coverage through federally-established Exchanges. If the Court overturns the IRS's interpretation of Code Section 36B, then these individuals would not be eligible for federal subsidies even if they otherwise qualify based on income, absent some type of legislative or administrative "fix" that permissibly responds to the Court's ruling.

Likewise, insurers who offer products on federally-established Exchanges could potentially be deprived of billions of dollars in premium dollars that they expected to receive for coverage sold on such Exchanges. And if no subsidies are available in those states, then potentially many more people will qualify for a hardship exemption from the ACA's individual mandate (which is generally available when the cost of coverage exceeds 8 percent of an individual's income), allowing such individuals to opt-out of buying health insurance and thus adversely affecting the risk pool in these states, potentially forcing premiums to rise.

Additionally, if the Court rules that subsidies for coverage obtained through a federally-established Exchange are not available, the ACA's employer mandate penalty would not apply to large employers with full-time employees who obtain coverage through federal Exchanges. This is because the employer mandate penalty only kicks in when a full-time employee receives a federal subsidy for coverage purchased through an Exchange. If subsidies are not available for coverage offered through a federal Exchange, it follows that an employer could not be liable for a penalty with respect to employees who obtain coverage through a federal Exchange.

Next Steps

The Justices will attend a confidential conference on March 6th to vote on the outcome of the *King* case, after which drafting responsibility for the written opinion of the Court will be assigned. If Chief Justice Roberts is in the majority, he will assign the opinion to either himself or another member of the majority. If Chief Justice Roberts is not in the majority, then the most senior Justice in the majority will be responsible for assigning the opinion. We expect that the Court will issue its written decision at the end of its current term, near the end of June 2015.

We will provide updates as to the Supreme Court's ruling – and its implications for insurers and plan sponsors – as events unfold.