June 29, 2012

Introduction

On Thursday, June 28, 2012, the United States Supreme Court issued its ruling in *National Federation of Independent Business v. Sebelius,* addressing the constitutionality of the health care reform legislation known as the Patient Protection and Affordable Care Act of 2010 ("Affordable Care Act" or "the Act" or "PPACA"). President Obama signed the Affordable Care Act into law with the goal of increasing health insurance coverage while reducing the growth of health care spending. One of the principal features of the Act was the requirement that all individuals purchase health insurance or pay a penalty in the form of a "shared responsibility payment" to the IRS (i.e., "the individual mandate"). Almost immediately after being signed into law, numerous plaintiffs, including 28 States, filed legal challenges to the Act.

The Court addressed three main legal challenges: (1) whether the Anti-Injunction Act barred the present challenge; (2) whether Congress had the constitutional authority to enact the individual mandate under its power to regulate interstate commerce or its power to tax; and (3) whether Congress had the constitutional power to enact the Medicaid expansion portion of the Act that penalizes states that choose not to implement the expansion. In a 5-4 decision written by Chief Justice Roberts, the Court held that: (1) the Anti-Injunction Act did not apply and therefore did not prevent the Court from hearing the case; (2) Congress had the authority to enact the individual mandate pursuant to its power to tax, but not under the Commerce Clause; and (3) Congress exceeded its Spending Clause powers in mandating the States participate in the Medicaid expansion or else lose all of their Medicaid funding, but States may still opt-in to the Medicaid expansion.

Anti-Injunction Act

As an initial matter, Chief Justice Roberts explained why the Anti-Injunction Act does not apply. Under the Anti-Injunction Act, a person can only challenge a tax by seeking a refund after having paid the tax. Because the Affordable Care Act will not start collecting shared responsibility payments until 2014, at issue was whether the challenge to the individual mandate sought prematurely to prevent the government from collecting tax. The Court, however, held that Congress intentionally characterized the Affordable Care Act's shared responsibility payments as a "penalty" and not a "tax;" therefore, the Anti-Injunction Act did not apply.

Individual mandate

The Affordable Care Act's individual mandate requires almost all Americans to purchase health insurance. If a person is not exempt and does not have insurance, the person must make a shared responsibility payment—or "penalty"—to the federal government. The amount is based on the person's household income and paid to the IRS along with the person's regular taxes.

At issue for the Court was whether Congress had the constitutional power to enact the individual mandate. The Court focused on two possible sources of constitutional authority: (1) the Commerce Clause and (2) Congress's power to tax.

Commerce Clause

The Commerce Clause empowers Congress to regulate interstate commerce. In the lawsuit, the government argued Congress had

the power to enact the individual mandate under the Commerce Clause because uninsured Americans have a substantial and detrimental effect on interstate commerce. Specifically, the cost of providing care to uninsured individuals is passed on to other insureds via higher premiums.

The Court ruled that the Commerce Clause gives Congress only the power to regulate commerce, not compel it. In other words, the Commerce Clause regulates activity, not inactivity. The individual mandate does not regulate commercial activity. Instead, it compels people to purchase insurance when they might otherwise not. Congress cannot justify a regulation on the ground that people's inactivity has an effect on interstate commerce. To allow such an expansive view of the Commerce Clause "would open up a new and potentially vast domain to congressional authority." The Court was not willing to stretch the Commerce Clause that far.

Power to tax

The government alternatively argued that Congress had the authority to enact the individual mandate using its power to tax. The Court considered whether it was reasonable to view the individual mandate as a tax on people who elect not to purchase insurance versus an order compelling people buy it. The Court concluded it was reasonable to construe the individual mandate as a tax. If an individual does not have insurance, the only consequence imposed by the Act is that the individual must pay a tax. Thus, not having insurance is simply a taxable event, just like buying gasoline or earning income.

Although this is not the most natural reading of the regulation, the Court recognized it only needed to determine if the interpretation was "fairly possible." The fact that Congress labeled the shared responsibility payment a "penalty" and not a "tax" was not determinative.

Therefore, Congress had the constitutional power to enact the individual mandate pursuant only to its power to tax, not under the Commerce Clause.

Medicaid

Turning to PPACA's expansion of the Medicaid program, the Court found that Congress had overreached in requiring States to participate in PPACA or risk losing all of their federal Medicaid funding. Beginning in 2014, the Affordable Care Act requires that States extend Medicaid coverage to cover all individuals under 65 with incomes below 133 percent of the federal poverty line or stand to lose *all* of their federal Medicaid funding.

Congress purported to enact PPACA under the Spending Clause, which grants Congress the power "to pay the Debts and provide for the … general Welfare of the United States." The Court was not persuaded. It first rejected the argument that PPACA's Medicaid provisions were only an expansion of existing Medicaid and were therefore simply conditions on the use of the original Medicaid funding. The Court also concluded that Congress could not incentivize States to participate in the Medicaid expansion by threatening to withhold *all* federal Medicaid funding. This amounted to "economic dragooning," rather than merely providing encouragement to participate. In other words, the financial inducement offered by Congress was essentially "a gun to the head," and exceeded Congress's power under the Spending Clause.

Accordingly, the Court held that States may choose whether or not to provide the additional Medicaid benefits authorized by PPACA, and if they choose not to, they can only lose the *additional* funding for those benefits—not *all* Medicaid funding.

Consequences of the ruling

With Thursday's Supreme Court decision, the vast majority of PPACA remains the law. The Court's decision means health care

industry stakeholders need to get started responding to PPACA, to the extent they have delayed doing so. PPACA's key requirements that will need to be addressed include:

- Employers must implement administrative requirements and changes in benefit plan design, and those with over fifty employees must decide whether to implement group health plan coverage for all full time employees (anyone working over 30 hours per week) by January 1, 2014, or otherwise face possible penalties.
- States must decide whether to create a Health Insurance Exchange, a marketplace that individuals and eligible employers can use to compare health insurance options; if they fail to do so by January 1, 2014, the Department of Health and Human Services may impose a Federally-Facilitated Exchange, standing alone or as a partnership with a State.
- Insurers and health plans must comply with coverage requirements for adult children, restrictions on lifetime and annual limits, and removal of preexisting conditions exclusions, and they must continue providing PPACA-mandated rebates to consumers if they fail to spend 85% of premiums (or 80% for smaller plans) on medical care and quality improvement.
- Providers of services and suppliers wishing to receive shared savings payments through the Medicare Shared Savings Program must manage and coordinate care through an Accountable Care Organization ("ACO") and meet quality performance standards. The development of ACOs will drive new consolidation, possibly fostering increased mergers and acquisitions and investments involving health care providers and technology.
- Manufacturers of drugs and devices affected by PPACA's "sunshine provisions" must prepare for data collection, starting as early as January 1, 2013, and report payments and transfers of value to covered recipients (such as physicians and teaching hospitals) along with their ownership or investments interests. Manufacturers participating in Medicaid must continue providing higher rebates (increased by PPACA to 23.1% of Average Manufacturer Price for brand name drugs and 13% for generics).
- Device manufacturers face an excise tax of 2.3% of the price of any "taxable medical device," to be imposed starting January 1, 2013.
- Biologics will benefit from twelve years of marketing exclusivity, and an abbreviated pathway will apply for the approval of biosimilar products shown to be biosimilar to, or interchangeable with an FDA-licensed reference biological product.

Certain stakeholders may make calculated decisions not to participate in PPACA's incentives aimed at expanding coverage. Perhaps the biggest immediate impact of the ruling will be on the Medicaid expansion portion of the Act. Of the estimated 30 to 40 million people that will obtain health care coverage under the PPACA, some 17 million were expected to receive coverage under the Medicaid expansion. But this assumes all States would participate in the expansion. Twenty-six States challenged the constitutionality of the Medicaid expansion,[1] and some already have threatened to opt-out. While experts disagree about whether those States will actually do so given the strong financial incentive to participate—full federal funding for three years and roughly 90% thereafter—it remains to be seen whether some States may follow through on their threats.

Moreover, Employers and individuals may elect to pay penalties rather than meet coverage minimums or pay for insurance. As a result, it remains to be seen whether the anticipated benefits of expanded coverage will fully materialize for everyone from hospitals insurers to the pharmaceutical industry hoping to benefit from expanded demand for health care services.

While the Supreme Court decision regarding PPACA increases regulatory certainty for the near term, for its most vigorous opponents, the option to fight PPACA remains, creating further uncertainty. Political opponents are already outspoken about their desire to modify or even repeal the law, and to propose targeted legislation carrying out this intent. In the meantime, however, the immediate battleground will shift to regulations implementing PPACA's many provisions. Regulatory agencies are expected to produce a number of new rules in the near term implementing PPACA, which will affect the many stakeholders and accelerate the reform.

NOTES

1 Alabama, Alaska, Arizona, Colorado, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, Michigan, Mississippi,

Nebraska, Nevada, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Washington, Wisconsin, and Wyoming.

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