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## Supreme Court Declines to Return Health Reform to its Pre-Existing Condition

In a landmark decision, the U.S. Supreme Court upheld the constitutionality of the Patient Protection and Affordable Care Act (PPACA), ruling that:

- The individual mandate was a valid exercise of Congress' taxing power under the Constitution although the mandate exceeded Congress' authority under the Commerce Clause.
- The expansion of Medicaid under PPACA is constitutional but Congress cannot coerce states into accepting that expansion by taking away federal funding for *existing* Medicaid programs if a state declines to expand its Medicaid coverage.

[\*National Federation of Independent Business v. Sebelius\*, 567 U.S. \\_\\_\\_\\_ \(2012\), 2012 WL 2427810.](#)

### Background

#### The Law

With the enactment of PPACA, Congress sought to achieve near-universal health coverage of Americans by precluding insurers issuing individual health policies, group insurers and group health plans from denying coverage for pre-existing conditions; requiring health insurers to set premiums based on community rating, rather than the individual risks of an insured; mandating the establishment of insurance exchanges by 2014 through which individuals will be able to buy health insurance from private insurers that meet established standards; requiring most individuals who do not have coverage through an employer plan, a government program or otherwise to obtain health insurance covering certain essential health benefits; and expanding Medicaid coverage to cover uninsured persons who are not able to afford to buy insurance even with certain income-based federal subsidies that will be available.

**Individual Mandate.** The individual mandate was enacted as section 5000A of the Internal Revenue Code of 1986, as amended (the Code) to become effective for tax years ending after December 31, 2013. This section of the Code provides that "applicable individuals" must be covered by minimum essential coverage for both themselves and their dependents who are applicable individuals for each month beginning on or after January 1, 2014. If taxpayers who are applicable individuals fail to buy this coverage either for themselves or their dependents who are applicable individuals, the taxpayers must pay a penalty with their federal income tax returns (the "shared responsibility payment"). Under these rules, applicable individuals include all individuals who are citizens or nationals of the U.S., but not illegal aliens, persons in prison or persons covered by certain religious exceptions. The amount of the penalty for failure to buy coverage is the lesser of (1) a specified dollar amount, or (2) the national average premium for the lowest level of coverage (the bronze level) offered through the insurance exchanges for the year. The dollar amount is the greater of (1) a flat dollar amount times the number of applicable individuals in the taxpayer's family, but not more than three, or (2) a percentage of the taxpayer's household income in excess of the taxpayer's income tax exemptions and basic standard deduction. The flat dollar amount, which is phased in for 2014 and 2015, is \$695 for 2016 and will be indexed thereafter. The Code also includes an exemption from the penalty for applicable individuals for whom the

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contributions for the required minimum essential coverage are considered unaffordable, *i.e.*, the contribution would exceed 8% of the individual's household income. Finally, Code section 5000A provides that no criminal sanctions or penalties may be imposed on a taxpayer for failure to make the shared responsibility payment and that a failure to make the payment cannot be the basis for filing a lien or levying on a taxpayer's property.

**Medicaid Expansion.** Medicaid was enacted in 1965 to provide matching federal funds to states to establish programs to provide health coverage to needy persons. Federal law sets broad parameters, and each state establishes its own eligibility standards; determines the type, amount, duration, and scope of services; sets the rate of payment for services; and administers its own program within those guidelines. States were not required to establish Medicaid programs, but they were required to adhere to the minimum federal standards to obtain the matching federal funds. All 50 states, the District of Columbia and all U.S. territories have established Medicaid programs and have accepted federal funds for the operation of those programs.

Currently the federal rules require coverage of pregnant women, children, families with children, the elderly, the blind and disabled individuals whose income is less than certain levels, with the rules setting different income levels for the different groups. Each state has the option to adjust the income levels to expand certain groups or to provide coverage for certain other categories of individuals and to receive federal matching funds for those groups. To extend coverage even more broadly to low-income Americans, PPACA requires states to provide Medicaid to all individuals under 65 with incomes below 133% of the federal poverty line. PPACA further requires that the Medicaid benefits offered to newly eligible individuals must be sufficient to provide minimum essential coverage that would be required under the individual mandate. This expansion of Medicaid was projected to provide coverage to 17 million uninsured Americans.

The Supreme Court cited statistics showing that the federal government currently pays for 50% to 83% of a state's Medicaid spending. A statement on the Social Security Administration's website says that the federal government's reimbursements are required by law to fit within that range and that the average for fiscal year 2011 was 59%. PPACA provides that the federal government will pay 100% of the cost of the Medicaid expansion for 2014 through 2016, from 95% decreasing to 93% of the cost for 2017 to 2019, and 90 percent of the cost thereafter. However, a provision of the law that was not amended by PPACA provides that the Secretary of Health and Human Services (HHS) may discontinue all or a portion of Medicaid funding to a state if the Secretary finds that the state's program does not meet the requirements for the program, including the Medicaid expansion provisions that were included as amendments to the existing parameters for Medicaid programs. This section of the statute also includes a severability clause, which provides that, if any provision of the law or any application of it is held invalid, that is not to affect either the remainder of the law or the application of the law to other situations.

### **Lower Courts**

On the day that PPACA was enacted, March 23, 2010, several suits were filed in federal court challenging the constitutionality of the law, and other suits were filed soon after. Several of the cases made their way through the courts fairly quickly. Of the more than 20 challenges that were filed, decisions had been reached in four of the courts of appeals in five cases by the time the Supreme Court granted certiorari to hear an appeal from the decision by the U.S. Court of Appeals for the Eleventh Circuit in November 2011. In the cases that had been heard by the courts of appeals:

- The Eleventh Circuit held that the individual mandate was unconstitutional, but that it could be severed from the remainder of PPACA, so that the rest of the law could be implemented.

*National Federation of Independent Business v. Sebelius*, 2011 WL 3519178 (11th Cir. Aug. 12, 2011).

- The Sixth Circuit held that Congress had the authority to enact the individual mandate and that it is not unconstitutional. *Thomas More Law Ctr. v. Obama*, 2011 WL 2556039 (6th Cir. June 29, 2011).
- The Fourth Circuit issued two decisions. In *Liberty Univ. v. Geithner*, 2011 WL 3962915 (4th Cir. Sept. 8, 2011), it held that a decision on the merits was premature at this time under the Anti-Injunction Act, also known as the Tax Injunction Act, which essentially provides that provisions of federal law imposing taxes cannot be challenged until the taxes are due. Under this reasoning, the individual mandate cannot be challenged until 2015. In *Virginia ex rel. Cuccinelli v. Sebelius*, 2011 WL 3962915 (4th Cir. Sept. 8, 2011), the Fourth Circuit held that the state of Virginia lacked standing to bring a challenge.
- The District of Columbia Circuit held that the individual mandate is constitutional. *Seven-Sky, et al. v. Holder, et al.*, 2011 WL 5378319 (DC Cir. Nov. 8, 2011).

When granting certiorari on the Eleventh Circuit case, the Court did not take action on the petitions filed by the plaintiffs in the *Thomas More*, *Liberty University* and *Cuccinelli* cases. All the parties to the Eleventh Circuit's decision, including the Obama administration, had filed petitions requesting that the Supreme Court review the case. The case was viewed by the parties, again, including the government, as the best case to proceed for several reasons:

- There was no challenge to the standing of the plaintiffs, which included 26 states, the National Federation of Independent Business (NFIB) and two individuals. In contrast, the standing of the Thomas More Law Center had been questioned, and Virginia had been found to lack standing.
- The Eleventh Circuit decision reached the issues of both the constitutionality of the individual mandate and whether that provision is severable from the balance of PPACA. Thus, both issues could be reviewed on appeal to the Supreme Court. In contrast, the Sixth Circuit did not reach the issue of severability of the mandate since it found the individual mandate constitutional, and the Fourth Circuit did not reach either issue. The Court was aware, however, that none of the parties to the case supported the Eleventh Circuit's holding that the mandate is severable; thus, the Court assigned an *amicus* to brief and argue in support of severability.
- Though the application of the Anti-Injunction Act had not been decided in the Eleventh Circuit, there is a split in the Circuits on that issue. As noted above, the Fourth Circuit held the challenge to PPACA was premature based on the Anti-Injunction Act; the Sixth Circuit held to the contrary. The Obama administration's petition for certiorari asked that the Supreme Court hear arguments on that question, maintaining that the Anti-Injunction Act does not bar a decision on the merits. The Court's order granting certiorari directed the parties to file briefs on, and argue, the issue of whether the suit was barred by the Anti-Injunction Act. Knowing that none of the parties to the case believed the Anti-Injunction Act was applicable, the Court assigned an *amicus* to brief and argue the issue that the Anti-Injunction Act barred the current challenge to the individual mandate as premature.

As noted above, all of the parties to the Eleventh Circuit decision filed petitions for certiorari. The NFIB and the two individuals, who filed one petition, sought review only on the question of whether the individual mandate is severable from the other provisions of PPACA. The Obama administration sought

review of the question of Congressional authority to enact the individual mandate, in addition to raising the question on the bar possibly presented by the Anti-Injunction Act. The 26 states filed a separate petition raising three questions on: (1) the constitutionality of the individual mandate and its severability; (2) the ability of Congress to impose “onerous conditions” on states in expanding Medicaid, an argument which the Eleventh Circuit rejected; and (3) whether Congress can treat states in the same manner as other employers when imposing employment-based mandates. The last issue relates to the “employer responsibility” or “pay or play” provisions of PPACA that impose taxes on large employers that do not provide minimum health coverage to employees. The district court had said that states could be treated the same as any other employers based on an earlier Supreme Court decision, and the Eleventh Circuit declined to rule on the issue on the basis of that earlier case. The Supreme Court apparently agreed with the district court’s holding on this issue since it did not grant certiorari on this question.

## The Court’s Decision

### Anti-Injunction Act

The Court determined that the Anti-Injunction Act does not bar the challenge to PPACA because the amount someone must pay for failure to comply with the individual mandate is not a tax for purposes of the Anti-Injunction Act. Congress consistently used the term “penalty” to describe and refer to the shared responsibility payment for failure to comply with the individual mandate under Code section 5000A. While Congress’ decision to label the payment as a “penalty” rather than a “tax” is not dispositive for constitutional purposes (see the discussion below regarding application of the Congressional taxing power), the Court held that Congress’ decision to couch the payment as a penalty is significant for purposes of statutory interpretation under the Anti-Injunction Act, because that Act bars premature challenges to the assessment of taxes, not penalties. Given the absence of statutory language in PPACA suggesting that the penalty should be treated as a tax for Anti-Injunction Act purposes, the Court found that the Anti-Injunction Act does not bar a challenge to PPACA.

### Individual Mandate

On brief and in oral argument, the federal government defended its authority to enforce the individual mandate primarily in reliance on two of Congress’ enumerated constitutional powers: the power to regulate the economic effects of interstate commerce (the Commerce Clause) and the power to make laws that are necessary and proper for carrying out Congress’ enumerated powers (the Necessary and Proper Clause). Citing the national economic impact of the cost of treating individuals who do not have health insurance and the shifting of those costs to others, the government argued that the individual mandate is an appropriate exercise of Congress’ Commerce Clause power as it seeks to expand health care coverage and control health care costs. Furthermore, the government asserted that Congress has the constitutional authority to effect the individual mandate under the Necessary and Proper Clause because the mandate is integral to implementing broad, comprehensive health care coverage. Petitioners countered that the individual mandate is beyond the bounds of Congress’ authority under the Commerce and Necessary and Proper Clauses, because it seeks to regulate economic inactivity – the failure to purchase health insurance – rather than economic activity.

The majority of the Court agreed with petitioners. The Court noted that the mandate does not regulate existing interstate economic activity, but instead compels individuals to become active in interstate commerce because the failure to do so would have an economic impact. Allowing Congress to regulate individual inaction, according to the Court, is beyond the scope of Congress’ power under the Commerce Clause and is not supported by the Court’s decisions in prior cases. In addition, the Court held that Congress did not have the power to enact the individual mandate under the Necessary and Proper

Clause, since that power applies only when Congress carries out its specifically enumerated powers, such as the power to spend, levy taxes or raise an army. In this case, although the individual mandate might be necessary to health insurance reform, the individual mandate is not a proper means to effect that reform since it is not incidental to an exercise of the commerce power. To allow otherwise, according to the Court, would be an unprecedented and unacceptable expansion of federal legislative authority.

### **Congress' Taxing Power**

Although the Court found that Congress lacks the power to compel individuals to purchase health insurance under the Commerce and Necessary and Proper Clauses, the majority held that the individual mandate survives as a valid exercise of Congress' constitutional power to lay and collect taxes (the Tax Clause).

The government asserted that the shared responsibility payment for failure to comply with the individual mandate is a tax applicable only to those who choose not to purchase health insurance. In support, the government pointed to the indicia of taxation inherent in the regulatory scheme: the payment is fully integrated into the tax system (being provided for in the Code and paid to the Internal Revenue Service with a taxpayer's income tax return), raises revenue for the government and triggers only tax consequences for noncompliance. In its decision, the Eleventh Circuit questioned the validity of this argument and held that Congress' decision to label the payment as a "penalty" and not a "tax" under Code Section 5000A disavowed any reliance on Congress' taxing power. The petitioners encouraged the Court to affirm this finding of the Circuit Court.

Citing precedent on the need for deference to the legislature, however, the Court determined that if the government's interpretation of the shared responsibility payment as a tax is "fairly possible," the individual mandate must stand as a constitutional exercise of Congress' taxing power. Again citing precedent, the Court noted that Congress' decision to couch the payment as a penalty and not a tax under the statute was not dispositive for constitutional purposes, particularly given that the statutory "penalty" has certain key characteristics of a tax, as described above. Using a functional analysis, the Court determined that the mandate could reasonably be interpreted as an appropriate exercise of Congressional taxing power for three reasons: (1) the amount of the payment is limited to the cost of purchasing health insurance, and unlike a penalty, is not so excessively large as to be a prohibitive financial punishment; (2) no showing of willful intent not to purchase health insurance is required to trigger the payment, and the payment is not punishment for an unlawful act, since the purchase of health insurance alone would bring an individual into compliance with the statute; and (3) the payment is collected through the normal means of taxation, and the government cannot use punitive action, such as the imposition of criminal prosecution, to collect the tax.

The Court reconciled its decision to uphold Congress' regulation of individual inaction under the Tax Clause with its decision not to uphold the regulation of the same individual inaction under the Commerce Clause by pointing to the government's remedies in each circumstance. While Congress' Commerce Clause powers should be interpreted narrowly according to the Court, the government has a wide range of remedies available for noncompliance with laws enacted using that power, including criminal sanctions and deprivation of individual rights. Because an individual can avoid regulation under the Commerce Clause by simply abstaining from federally regulated interstate activity, individual inactivity should not be made subject to the full weight of Congress' Commerce Clause power. In contrast, Congress' power to tax is broadly interpreted and unavoidable, but Congress' remedies for noncompliance are limited to requiring payment to the Treasury; otherwise, the individual has no independently enforceable legal obligation under such laws. Since lawful inaction can be remedied under a taxing statute simply by



paying a tax, the Court found that the regulation of inactivity through the Tax Clause<sup>1</sup> is an appropriate exercise of Congressional legislative authority.

Finally, while the Court opted not to elaborate on this point, the majority made clear that Congress' power to tax is broad, but not infinite. If Congress uses its taxing power to invoke punitive sanctions, the Court warned that any such action would likely reach beyond the scope of its taxing power.

### Medicaid Expansion

The Court further held that the expansion of Medicaid under PPACA was a constitutional exercise of Congress' authority "to pay the Debts ... and provide for the general Welfare of the United States" (the Spending Clause). However, the Court found that the government's power under the law in effect prior to the enactment of PPACA to withdraw *existing* Medicaid funding for a state's failure to implement the Medicaid expansion would flout the principle that the federal government cannot compel the states to institute a federal program. While the Court noted that Medicaid funding that is contingent upon complying with federal rules is valid under the Spending Clause, a state's agreement to comply with the federal standards is in the nature of a contract. Thus, the legitimacy of Congress' Spending Clause authority rests on whether the state can voluntarily accept the terms of the agreement or reject the terms as it sees fit. If states are compelled to take action that they otherwise would not as a result of federal coercion, however, that violates the limits of Congress' spending authority. Although Congress would be well within its authority to withhold funding for the expansion of Medicaid if states refused to comply with PPACA's Medicaid expansion, the Court found that a threat that extends to the state's entire existing Medicaid program imposes new conditions on an existing agreement and amounts to federal coercion.

Despite this conclusion, the Court did not find it necessary to hold that PPACA's Medicaid expansion is unconstitutional. Instead, the Court found that the severability clause contained in the pre-PPACA statute provided a clear indication that Congress wanted the Medicaid rules to be upheld and applied to the greatest extent possible. The severability clause further gave the Court the ability to specify that HHS does not have the authority to withdraw existing Medicaid funds from states that decline to comply with the expansion, leaving the Medicaid expansion intact.

### What is Next?

An obvious question following the Supreme Court decision is whether all of the states will enact the Medicaid expansion under PPACA now that the Supreme Court has made it possible for the states to decline the Medicaid extension and still maintain their existing Medicaid programs and reimbursements. The Associated Press has quoted officials from some states as saying that, even with the federal government paying for 100% of the cost for the first three years and never less than 90%, Medicaid expansion will be too costly for their states. According to the Associated Press, officials in other states are waiting until after the November election to take a position. *The Wall Street Journal* and other media outlets have reported that hospitals and other health care providers are beginning a lobbying effort to convince states to adopt the Medicaid expansion. Finally, now that the Supreme Court has upheld PPACA, Republican leaders in the U.S. House of Representatives have made clear their intention to repeal PPACA, beginning with a House vote on legislation that would repeal the entire statute scheduled for July 11.

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<sup>1</sup> The Court also noted that while the shared responsibility payment is a tax, it is not a "direct tax" under Article I of the Constitution that requires apportionment among the states, because it is triggered by particular circumstances (rather than simply being a per-capita tax without regard to other circumstances) and is not a tax on land or property.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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