King & Spalding
Client Alert

DECEMBER 17, 2018

For more information, contact:

Christopher P. Kenny
+1 202 626 9253
ckenny@kslaw.com

Kathy Lynn Poppitt
+1 512 457 2004
kpoppitt@kslaw.com

Mark D. Polston
+1 202 626 5540
mpolston@kslaw.com

Travis Jackson
+1 213 443 4374
tjackson@kslaw.com

Ashley C. Parrish
+1 202 626 2627
aparrish@kslaw.com

Allison F. Kassir
+1 202 626 5600
akassir@kslaw.com

Jonathan H. Shin
+1 213 443 4334
jshin@kslaw.com

King & Spalding

Washington, D.C.
1700 Pennsylvania Avenue, NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500

Austin
500 W. 2nd Street
Suite 1800
Austin, Texas 78701
Tel: +1 512 457 2000

What Next for the ACA after *Texas v. U.S.*? What the Industry Needs to Know While the Case Is on Appeal

United States District Court Judge Reed O'Connor of the Northern District of Texas issued a ruling on Friday, December 14, 2018, declaring the Patient Protection and Affordable Care Act (ACA) unconstitutional in its entirety. Judge O'Connor declared the ACA's individual mandate unconstitutional because of recent federal tax reform, which reduced to zero "shared responsibility payments" that unexempt individuals were required to pay if they chose not to be insured. Judge O'Connor held that by reducing the shared responsibility payments to zero beginning January 1, 2019, Congress effectively repealed the individual mandate itself since it carried no penalty. The ruling further reasoned that because the individual mandate could not be severed from the rest of the ACA, the ACA in its entirety is invalid. Supporters of the ACA have already expressed an intent to immediately appeal Judge O'Connor's decision, which will leave the ACA in place for the immediate future. Indeed, Judge O'Connor did not enjoin any provisions of the ACA and the Trump administration announced shortly after the opinion was issued that the ACA would remain the law of the land while appeals are pending. However, the ruling initiates a period of uncertainty throughout the U.S. healthcare system. This Client Alert summarizes Judge O'Connor's reasoning and the major implications of his ruling.

Background

The ACA established a mandate that individuals maintain minimum health insurance coverage (commonly known as the "individual mandate") and a shared responsibility payment imposed on non-exempt individuals who chose not to obey this mandate. The mandate was principally designed to incentivize the purchase of health insurance by relatively healthy individuals, who typically chose not to do so, in order to expand and improve the risk pool of

the individual insurance marketplace to absorb the entry of typically sicker and more costly patients that had been priced out of or denied coverage. The enactment of the ACA brought about multiple court challenges to its constitutionality. The first challenge was decided by the U.S. Supreme Court in 2012 when the Court upheld the ACA's constitutionality in *National Federation of Independent Businesses v. Sebelius* (*NFIB)*. Chief Justice Roberts authored the majority's opinion that while the individual mandate is not sustainable under the Interstate Commerce Clause, the shared responsibility payment acted as a tax and, in conjunction with the individual mandate, was therefore a valid exercise of Congress's Tax Power. The ACA included dozens of other provisions affecting nearly every corner of the healthcare industry, including Medicaid expansion, establishment of the Center for Medicare and Medicaid Innovation, numerous Medicare payment and regulatory reforms, and various public health initiatives, that are not affected by the individual mandate or necessarily funded by shared responsibility payments.

However, earlier this year an alliance of 19 Republican state attorneys general and the governor of Maine, led by the Texas Attorney General, initiated legal proceedings in the Northern District of Texas against the United States and, led by the Attorney General of California, 17 other state attorneys general as intervenor defendants. Plaintiffs sought, among other things, a declaration that the individual mandate was rendered unconstitutional as a result of tax reform enacted by last year's Tax Cuts and Jobs Act of 2017 (TCJA). Plaintiffs further argued that the individual mandate was an essential provision inseverable from the rest of the ACA, and therefore the ACA in its entirety must be declared unconstitutional.

In June, the U.S. Department of Justice informed Judge O'Connor that it would not defend the ACA in its entirety. DOJ stated that it disagreed with the plaintiffs that every provision of the ACA should be struck down, arguing instead that only two provisions sufficiently related to the individual mandate required invalidation: the guaranteed-issue provision, which prohibits insurers from denying coverage or charging higher rates for individuals with pre-existing conditions, and the community-rating provision, which limits insurers from charging consumers premiums that differ based on age or gender. In its briefs, DOJ argued that only these two provisions are inseverable because the individual mandate is necessary to prevent adverse selection and to broaden the health insurance pool to include healthy individuals, which will in turn lower premiums that otherwise would spike if only more costly individuals entered the marketplace. DOJ argued that all other provisions of the ACA should remain in effect, and asked Judge O'Connor to delay issuing any decision until after the conclusion of the 2019 open enrollment period.

Judge O'Connor's Decision

Judge O'Connor agreed with the plaintiffs. Though the plaintiffs initially sought a preliminary injunction until resolution of the pending action, Judge O'Connor issued a summary judgment ruling in favor of the plaintiffs but denied their request for an injunction. In his 55-page opinion, Judge O'Connor first held that since the TCJA effectively eliminated the shared responsibility payment, the individual mandate no longer triggers a tax but now serves as a standalone command, unrelated to any tax, that continues to be impermissible under the Interstate Commerce Clause (as decided in *NFIB*) and is therefore unconstitutional. Judge O'Connor reasoned that the individual mandate was buoyed by Congress's Tax Power only because it triggered a provision that produced at least some revenue through the shared responsibility payment. When the TCJA effectively eliminated that revenue potential, he ruled, the individual mandate no longer triggers a tax and is unconstitutional.

The intervenor defendants (i.e., the California-led coalition) argued that the individual mandate can still be fairly read as a tax because it continues to satisfy the tax factors discussed by the Supreme Court in *NFIB*, including that previous shared responsibility payments will make their way into the treasury for years to come. They contended that, due to the frequency of late payments and deferrals, the government will continue

to receive revenue from 2018 until 2020 or beyond. The intervenor defendants also pointed to other examples of Congress delaying or suspending taxes, such as the medical device tax, to argue that the shared responsibility payment has not been rendered unconstitutional merely because it will be $0 in 2019. Indeed, Congress could not repeal the individual mandate outright through the TCJA because doing so would have run afoul of Senate budget reconciliation rules. Congress only had the ability to adjust the shared responsibility payment rate, and a future Congress could again decide to raise it to its original level without having to re-enact it altogether.

Judge O'Connor was not persuaded by the arguments of the intervenor defendants. He found that because the TCJA eliminated the shared responsibility payment, the provision no longer produces revenue for the government, regardless of when the revenue is actually paid. He further found that suspending or delaying a tax is not equivalent to eliminating it and the TCJA does not merely suspend collection of the shared responsibility payment.

Judge O'Connor also agreed with the plaintiffs on their claim regarding the inseverability of the individual mandate from the rest of the ACA. The intervenor defendants argued that certain provisions of the ACA, including the guaranteed-issue and community-rating provisions, were clearly severable from and unrelated to the individual mandate. However, Judge O'Connor found that the individual mandate was essential to the ACA's architecture and Congress intended it to place the ACA's myriad parts in perfect tension. He stated:

> Yet the parties focus on particular provisions. It is like watching a slow game of Jenga, with each party poking at a different provision to see if the ACA falls. Meanwhile, Congress was explicit: the Individual Mandate is essential to the ACA, and that essentiality requires the mandate to work together with the Act's other provisions.

Though many expected Judge O'Connor, a conservative judge appointed by former President George W. Bush, to rule against the law at least in part, the breadth and timing of Judge O'Connor's ruling caught many by surprise.

What Does the Ruling Hold for Healthcare Providers?

Shortly after the ruling was issued, White House Press Secretary Sarah Sanders released a statement on behalf of the White House stating, "We expect this ruling will be appealed to the Supreme Court. Pending the appeal process, the law remains in place." Similarly, a notice now appears on www.healthcare.gov which reads, "Court's decision does not affect this season's open enrollment." Individuals were able to sign up for healthcare coverage through the ACA's marketplace until the December 15, 2018, deadline. Judge O'Connor's ruling came one day before the close of the enrollment period and enrollment reports due this week will give some insight as to whether the ruling cooled enrollment.

In the meantime, the ruling throws all of the ACA's reforms to both the insurance marketplace and government healthcare programs into flux. While these provisions will remain in effect during appeals, the potential breadth of the decision is profound. These include:

- *Reductions in Insurance Coverage for Patients*. These coverage options include the subsidized purchase of insurance through the individual exchanges, Medicaid expansion, the employer mandate, and mandatory coverage for individuals under the age of 26 on their parents' plans. The full extent of these consequences will be affected by the actions of other parties. For example, while the ACA's provision for enhanced federal matching to support Medicaid expansion would fall, many states would likely continue to cover those populations even with reduced matching payments while other states may end their expansions altogether.

- *Repeal of the 60-Day Overpayment Rule*. While the federal False Claims Act and related amendments and rulemakings would remain valid, the 60-day overpayment rule was enacted as a provision of the ACA. However, Congress could enact subsequent legislation – or CMS could potentially do so through rulemaking – to reinstate the 60-day overpayment rule.
- *The End of Hospital Price Transparency*? The ACA requires hospitals to "make public" a list of their "standard charge" for items and services. CMS has been particularly active in implementing this provision in the last year, recently stating in subregulatory guidance that hospitals must post their entire chargemaster for every item and service they offer. Hospitals have long argued that this directive is procedurally invalid and substantively at odds with the literal wording of the ACA. The provision remains in effect while the ACA is good law, but it is unclear if CMS has separate authority to require price transparency of this nature should Judge O'Connor's decision be upheld.
- *Reductions in Prescription Drug Rebates Required Under the Medicaid Program*. The ACA increased the percentages of rebates paid by pharmaceutical manufactures, leading to lower state and federal Medicaid costs. If these rebates were to reset to pre-ACA levels, many states may have additional incentive to pare back or eliminate Medicaid expansion.
- *Reversing the 75-Percent Cut in Medicare Disproportionate Share Hospital (DSH) Payments and the Uncompensated Care (UCC) Payment Program*. This is perhaps the biggest source of redistribution of funds from hospitals to help support extended coverage through exchanges and other government funded programs. Medicare and Medicaid DSH subsidize the costs of caring for uninsured people. With creation of the exchanges and Medicaid expansion, arguably less money is needed to cover the costs of the uninsured. Uninsured payments under the ACA moved from an uncapped amount of funds ("empirical DSH") to a system that distributes funds from a limited pool based on the national uninsured rate and each hospital's cost of providing uncompensated care. While the UCC payment system would be repealed, it is very likely that Congress would reenact a similar provision that subsidizes hospitals based on their actual costs of care (which is currently measured by statistics on Worksheet S-10 of the Medicare cost report). In short, repeal of the ACA would not likely mean an extended reversion to the old Medicare DSH program. Republicans in Congress have proposed using S-10 statistics for other purposes (e.g., participation in the 340B Drug Pricing Program), so hospitals must continue to complete and monitor their S-10 submissions.
- *Abolition of CMMI and the Medicare Shared Savings Programs (MSSP)*. The ACA gave CMS additional demonstration authority as well as money to fund the use of that authority. CMS has used this to develop the MSSP and Accountable Care Organization programs, as well as other demonstration projects. Initially, it would be difficult for CMS to continue these programs without that authority and funding. However, CMS does have other demonstration authority that is more limited in scope but does allow the agency to experiment with new payment models. It is possible that CMS would continue to pursue these projects with this alternative authority. Private payors that have adopted similar models may also continue to implement them independent of what CMS ultimately decides.
- *Restoration of Market Basket Decrease and Productivity Adjustments*. Judge O'Connor references $200 billion in cuts to hospitals to help pay for other provisions of the ACA. Much of this comes in mandatory downward adjustments to percentage increases in yearly inpatient payment rates due to application of a productivity adjustment in addition to other mandatory cuts. The productivity adjustment would be removed which, in theory, would lead to a higher inpatient rate in future years. However, it is possible that a future

> Congress would prospectively reenact these rate adjustments because of the significant Medicare cost increase that would result from removing them.

In addition, Judge O'Connor's decision, if upheld, would wipe out Section 501(r) of the Internal Revenue Code, which was added by the ACA to establish strict standards that nonprofit hospitals must satisfy in exchange for tax-exempt, charitable status. Currently, nonprofit hospitals are required to conduct community health needs assessments at least once every three years to determine the unmet health needs of the hospital's community and adopt an implementation strategy to outline how the hospital will address those needs; adopt and implement a financial assistance policy and emergency medical care policy; limit the amount that the hospital charges for emergency and other medically necessary care to those patients who qualify for financial assistance; and refrain from taking extraordinary collection actions, such as garnishing wages, until after the hospital has used reasonable efforts to determine whether an individual qualifies for financial assistance. Though section 501(r) may be vulnerable as a technical matter, nonprofit hospitals should not expect these requirements to vanish entirely even if Judge O'Connor's ruling is upheld. These provisions enjoy broad bipartisan support and would likely be included in subsequent legislation.

Possible Outcomes on Appeal

The next phase of this litigation is an appeal by the California-led coalition of intervenor defendants to the United States Court of Appeals for the Fifth Circuit. While impossible to predict, the Fifth Circuit could affirm or reverse Judge O'Connor entirely or agree with DOJ and invalidate only those provisions more central to survival of the individual mandate.

If the plaintiffs are successful again at the Fifth Circuit, the intervenor defendants will seek review by the Supreme Court. The Court likely will take the case, given the importance of the issues and the fact that the Court often reviews lower court rulings when major legislation is struck down. However, if the intervenor defendants prevail in the Fifth Circuit, it may be more difficult for plaintiffs to convince the Court to weigh in as there would likely not be any split in the circuits and the Fifth Circuit's decision will be upholding the law. Framing of the arguments before the Fifth Circuit, the judges appointed to the panel, and whether the panel issues separate opinions, all will be critical in the next stage of litigation. (Indeed, two of President Trump's appointments to the Fifth Circuit were former attorneys at the Texas Solicitor General's Office, the office that managed the litigation before Judge O'Connor.)

Legislative Responses?

As soon as the new Congress convenes in January, the Democratic-controlled House of Representatives is expected to intervene in the case. Current House Democratic Leader and incoming Speaker Nancy Pelosi (D-CA), has promised "the House of Representatives will move swiftly to formally intervene in the appeals process" to uphold the ACA. Senate Minority Leader Chuck Schumer (D-NY) is also urging a vote to intervene in the case, though it is unlikely to take place under a Republican-controlled Senate.

Some in Washington, including President Trump and outgoing House Energy and Commerce Committee Chairman Greg Walden (R-OR), contend that the decision offers an opportunity for bipartisan compromise. However, it is not clear that consensus extends beyond the widespread agreement on protecting individuals with pre-existing conditions. Republicans will be resistant to take steps they perceive as further enshrining the ACA, and Democrats will resist efforts they perceive as undermining the law.

For instance, incoming Senate Finance Committee Chairman Charles Grassley (R-IA) promised his constituents they will not lose health coverage while the courts settle this issue and noted his committee will hold hearings on "a better way" to provide health coverage, as the ACA is "fatally flawed." (Chairman Grassley is also among the biggest supporters of the limitations placed on nonprofit hospitals by section

501(r).) Some Republicans have been working on legislation to restore parts of the ACA in the event the plaintiffs were successful. Senator Thom Tillis (R-NC) sponsored the "Ensuring Coverage for Patients with Pre-Existing Conditions Act," to require insurers to sell plans to individuals regardless of whether they have pre-existing conditions. However, the legislation would not require the insurer to cover treatments for a particular condition and would allow premiums to vary by age and gender.

Senator Lamar Alexander (R-TN) has been a leader among Republicans in working on various efforts to stabilize the insurance market, and his announcement that he will not seek reelection in 2020 may provide him additional flexibility in negotiating a bipartisan agreement. In March 2018, Senators Alexander and Susan Collins (R-ME), along with Representatives Walden and Ryan Costello (R-PA), attempted to add the Bipartisan Health Care Stabilization Act of 2018 (BHCSA) to an appropriations bill. However, the effort failed after Democrats insisted the legislation be exempted from the "Hyde amendment," which prohibits federal funding from being used for abortions. The BHCSA would have provided $30 billion for reinsurance or invisible high-risk pools in the nongroup insurance market, appropriated funds for cost-sharing reductions through 2021, and retained funding for ACA outreach and enrollment. The BHCSA incorporated elements of two bipartisan proposals developed by Senators Alexander and Patty Murray (D-WA) to appropriate CSR payments and by Senators Collins and Bill Nelson (D-FL) to provide funding for state reinsurance programs.

Incoming House Democratic committee leaders have promised to protect key provisions of the ACA and may begin with their March 2018 legislation, the "Undo Sabotage and Expand Affordability of Health Insurance Act of 2018," which would reverse a number of regulatory actions of the Trump administration, restore funding for ACA, and establish a national reinsurance program to help stabilize the market. Senate Democrats have not introduced companion legislation, but they have pursued targeted efforts to overturn Trump administration regulations that undermine the ACA. In October 2018, Democrats fell one vote short of a 51-vote majority to overturn an administration final rule on short-term, limited-duration health insurance plans.

King & Spalding will continue to monitor this litigation as it proceeds. Please contact us with any questions on how the litigation may affect your organization.