

SUPREME COURT UPHOLDS 2010 PATIENT PROTECTION AND AFFORDABLE CARE ACT

June 29, 2012

To Our Clients and Friends:

On June 28, 2012, in a historic decision, the Supreme Court of the United States (the “Court”) upheld the “individual mandate” provision of the Patient Protection and Affordable Care Act (the “Healthcare Act”)¹ enacted in 2010. In an opinion delivered by Chief Justice Roberts, and joined in relevant parts by Justices Ginsburg, Breyer, Sotomayor and Kagan, the Court (1) affirmed the validity of the individual mandate as part of Congress’s power to tax and, in addition, (2) held that Congress cannot sanction states that do not comply with the Medicaid expansion of eligibility requirements by taking away the states’ existing Medicaid funding.

BACKGROUND

On the same day that President Obama signed the Healthcare Act into law, Florida and 12 other states (later joined by several individuals, the National Federation of Independent Business and 13 additional states) filed a complaint in the United States District Court for the Northern District of Florida challenging the constitutionality of two key provisions in the Healthcare Act.

Individual Mandate

The plaintiffs challenged the so-called “individual mandate” that requires all lawful residents of the United States (with some specified exemptions) to maintain “minimum essential [healthcare insurance] coverage.”² Those persons who are not exempt and who do not receive the required coverage through a third party, such as their employer or a government program (*e.g.*, Medicare or Medicaid), are required to purchase health insurance. Individuals who violate this mandate are required to pay a monetary penalty assessed through their tax return.³ The plaintiffs argued that the individual mandate exceeded Congress’s powers under

¹ Pub.L. 111-148, 124 Stat. 119, codified as amended in various sections of the Internal Revenue Code and in 42 U.S.C.

² 26 U.S.C. § 5000A.

³ *Id.* § 5000A(c).

the Commerce Clause and the Necessary and Proper Clause of the U.S. Constitution.⁴ The district court agreed with the plaintiffs and struck down the Healthcare Act in its entirety by holding that the individual mandate provisions could not be severed from the rest of the Healthcare Act. On appeal, the United States Court of Appeals for the Eleventh Circuit agreed with the district court's ruling that the individual mandate was beyond the scope of Congress's power but ruled that the individual mandate provisions could be severed from the remainder of the Healthcare Act.

Expansion of Medicaid

The plaintiffs also challenged the Medicaid program expansion provisions requiring states, among other things, to expand their Medicaid coverage to include all individuals under the age of 65 with incomes that fall below 133% of the federal poverty line.⁵ States that choose not to participate in the expanded Medicaid program were at risk of losing their existing Medicaid funding.⁶ The plaintiffs argued that the Medicaid expansion exceeded Congress's powers under the Spending Clause of the U.S. Constitution.⁷ The district court did not reach the issue but the court of appeals held that the Medicaid expansion provisions were a valid exercise of Congress's power under the Spending Clause and rejected the argument made by the states that the threatened loss of their Medicaid funding violated the Tenth Amendment by forcing them to add millions of Americans to the Medicaid rolls on pain of loss of their existing Medicaid funding.

In the face of conflicting rulings in the Sixth and District of Columbia Circuits, which upheld the Healthcare Act in its entirety, and the Fourth Circuit, the Court granted certiorari.

THE COURT'S DECISION

Individual Mandate

In his opinion, Chief Justice Roberts disagreed with the Government's arguments that Congress has the power to enact the individual mandate under the Commerce Clause and/or the Necessary and Proper Clause. Although he acknowledged the "expansive scope"⁸ of the

⁴ U.S. Const. art. I, § 8, cl. 3, U.S. Const. art. I, § 8, cl. 18.

⁵ 42 U.S.C. § 1396a(a)(10)(A)(i)(VIII).

⁶ *Id.* § 1396c.

⁷ U.S. Const. art. I, § 8, cl. 3.

⁸ *Nat'l Fed'n of Indep. Bus. v. Sebelius*, No. 11-393, *slip op.* at 18 (U.S. June 28, 2012).

Commerce Clause and Congress's power to "regulate commerce" thereunder, Chief Justice Roberts stated that the individual mandate does not regulate existing commercial activity; rather, it compels individuals to become active in commerce by purchasing a product. In the words of Chief Justice Roberts, "[c]onstruing the Commerce Clause to permit Congress to regulate individuals precisely *because* they are doing nothing would open a new and potentially vast domain to congressional authority."⁹

With respect to the Necessary and Proper Clause, Chief Justice Roberts acknowledged the Court's usual deference to Congress's determination of "necessary" regulations, but explained that the Court has upheld federal laws under the Necessary and Proper Clause only in cases involving "exercises of authority derivative of, and in service to, a granted power."¹⁰ With the individual mandate, however, "Congress [has assumed] the extraordinary ability to create the necessary predicate to the exercise of an enumerated power."¹¹ Thus, Chief Justice Roberts concluded that the individual mandate cannot be sustained under either the Commerce Clause or the Necessary and Proper Clause.

In a separate joint opinion, Justice Scalia, joined by Justices Kennedy, Thomas and Alito, found that the individual mandate was beyond Congress's structural power under the Constitution, agreeing in substance with certain aspects of Chief Justice Roberts' separate opinion on the Commerce Clause point but going beyond that opinion's rationale in certain respects.¹²

A different majority, however, consisting of Chief Justice Roberts, joined by Justices Ginsburg, Breyer, Sotomayor and Kagan, agreed with the Government's argument that the individual mandate is within Congress's power under the Taxation Clause of the U.S. Constitution.¹³ In his opinion for the Court on the Taxation Clause issue, Chief Justice Roberts first pointed out that the Healthcare Act's description of the penalty as a "penalty" and not a "tax" cannot affect an issue of constitutional interpretation, and that accordingly

⁹ *Id.* at 19-20.

¹⁰ *Id.* at 28.

¹¹ *Id.* at 29.

¹² *Id.* at 129 (*Scalia, Kennedy, Thomas, and Alito, JJ., dissenting*).

¹³ *U.S. Const. art. I, § 8, cl. 3.*

“it does not determine whether the payment may be viewed as an exercise of Congress’s taxing power.”¹⁴ The analysis of whether an exaction is a tax turns on the substance and application of the exaction rather than its designation. The majority thus observed that, with respect to the individual mandate, the penalty is not so high that an individual has no choice but to buy health insurance; there is no scienter requirement that penalties for unlawful acts often require; and the penalty is collected by the IRS through normal means of taxation. Furthermore, a penalty is a “punishment for an unlawful act or omission”¹⁵ but the individual mandate does not attach negative legal consequences beyond a payment to the IRS and if an individual chooses to pay the penalty rather than obtain the required health insurance, such individual has complied with the law. Therefore, the individual mandate’s requirement to pay a monetary penalty for not obtaining health insurance “may reasonably be characterized as a tax”¹⁶ which is within the confines of Congress’s power under the Constitution. Justices Scalia, joined by Justices Kennedy, Thomas and Alito, dissented from this holding of the Court.¹⁷

Medicaid Expansion

In a plurality opinion, Chief Justice Roberts, joined by Justices Breyer and Kagan, held invalid the Healthcare Act’s expansion of the Medicaid provision which provided that a state may lose its existing Medicaid funding if it chooses not to participate in the expansion and voted to strike down that specific provision.¹⁸ Because the three-Justice plurality invalidated the expansion of Medicaid on the narrowest grounds of those Justices expressing a position on the Medicaid provision, the plurality opinion constitutes the law for purposes of the

¹⁴ No. 11-393, slip op. at 33.

¹⁵ *Id.* at 37.

¹⁶ *Id.* at 44.

¹⁷ *Id.* at 129 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting).

¹⁸ *The Court was divided on this point. Justices Ginsburg and Sotomayor found the provision to be constitutional in its entirety and voted to uphold it as written. Justice Scalia, writing for himself, and Justices Kennedy, Thomas, and Alito found the provision to be unconstitutional in its entirety, and voted to strike down the entire expansion program. However, Justices Ginsburg and Sotomayor also clarified in their opinion that if the provision was to be found unconstitutional, then their vote would be to strike down only the specific provision and not the entire program.*

Court's mandate governing the validity of those provisions and for purposes of the reasoning and import of the Court's decision in the lower courts.¹⁹

The Medicaid expansion provision of the Healthcare Act gave the Secretary of Health and Human Services the authority to withhold further Medicaid payments to a state if such state was determined to be out of compliance with any Medicaid requirement, including the expansion of eligibility required by the Healthcare Act.²⁰ Although Congress has the authority to condition receipt of federal funds by states, Congress cannot coerce states to accept such conditions, the plurality observed. With respect to the Medicaid expansion, Congress invalidly punished states that choose not to participate in the Medicaid expansion program by taking away their existing Medicaid funding, essentially leaving the states with no choice but to participate in the federal program. Relying on a severability clause in the same chapter as Section 1396c of the United States Code, the plurality ruled that the Healthcare Act, including the Medicaid expansion, remains valid except for the specific provision authorizing the Secretary of Health and Human Services to deprive non-complying states of their existing Medicaid funding.

IMPLICATIONS

The Court's decision on the Healthcare Act will undoubtedly provoke considerable discussion and will have significant practical impact on the business community as well as millions of individual Americans. Many providers and consumers of healthcare services have been awaiting resolution of the uncertainty surrounding the validity of the Healthcare Act due to the litigation. Now that the Court has ruled, individuals and businesses will need to focus carefully on the obligations imposed by the Healthcare Act.

With the Court's decision, the United States will continue to implement the Healthcare Act with the effective date of many new provisions being January 1, 2014 (note that some provisions were effective at implementation and others will be effective prior to January 1, 2014). "Large employers" (businesses with at least 50 full-time employees)²¹ in particular can expect a number of changes, some of which we have broadly summarized below.

¹⁹ See *Marks v. United States*, 433 U.S. 188, 193 (1977).

²⁰ 42 U.S.C. § 1396c.

²¹ 26 U.S.C. § 4980H.

Changes to employer-based health insurance

- Large employers that fail to offer minimum coverage under an eligible plan are required to pay “Shared Responsibility” penalties per full-time employee.²²
- Large employers with at least 200 employees that choose to offer health plans to their employees must automatically provide coverage for new full-time employees.²³
- Large employers should be prepared for changes in group health plans in order to comply with the terms of the Healthcare Act. For example, insurance companies will no longer be able to implement discriminatory policies based on pre-existing conditions,²⁴ and annual and lifetime coverage caps on spending for medical services will be prohibited.²⁵ The impact of these changes will vary by insurance company, but employers may reasonably anticipate that insurance premiums may rise in response to these expanded policies. Note, however, that not all provisions of the Healthcare Act will apply to all insurance plans; those plans that have been in place since March 23, 2010 will be grandfathered in and will be exempt from complying with certain consumer protection provisions of the Healthcare Act.²⁶

Changes to employer reporting requirements

Large employers must comply with several new reporting requirements. For example, most employers must disclose the dollar value of health insurance coverage on each employee’s annual Form W-2.²⁷ Additionally, employers are also required to submit certification statements summarizing benefits and coverage plans, including information on enrollment

²² *Id.* § 4980H.

²³ 29 U.S.C. § 218A.

²⁴ 42 U.S.C. § 300gg-3.

²⁵ 42 U.S.C. § 300gg-11.

²⁶ 42 U.S.C. § 18011.

²⁷ 26 U.S.C. § 6051.

waiting periods, monthly premiums, employer cost sharing, etc. These statements must also be furnished to certain employees.²⁸

Other Changes

- Individuals are required to obtain basic health insurance coverage or to pay a penalty. Individuals may apply for exemptions based on certain conditions. If states do not expand Medicaid eligibility, the individual mandate could provide additional incentive for that segment of the population that would have been covered by Medicaid expansion to secure private health coverage (note that a significant segment of this population is likely to be eligible for exemptions to the individual mandate based on income levels).²⁹
- For states that choose to expand coverage, Medicaid eligibility will increase to 133% of the federal poverty line.³⁰ States will receive 100% federal funding for the first three years to support this expanded coverage, phasing to 90% federal funding in subsequent years. Health reforms will vary widely across states based on current coverage levels, but this may mean that states could increase taxes to accommodate increased spending.
- The Healthcare Act will also have an impact on Medicare. For example, the Medicare Part D prescription drug benefit will be expanded to reduce the coverage gap,³¹ and physician incentives will be restructured.³²

²⁸ 26 U.S.C. § 6056.

²⁹ *Between 15 and 20 million individuals were estimated to become entitled to Medicaid benefits as a result of the Healthcare Act. America's Affordable Health Choices Act of 2009: Hearing on H.R. 3200 Before the H. Comm. on Ways and Means, 111th Cong. 1192 (2008) (dissenting views); John Holahan and Irene Headen, Urban Institute, Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or Below 133% FPL, Kaiser Commission on Medicaid and the Uninsured, May 2010, at 2; National Health Expenditure Projections 2010-2020, at 1, 2, <http://cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected.html>.*

³⁰ 42 U.S.C. § 1396a(a)(10)(A)(i)(VIII).

³¹ 42 U.S.C. § 1395w-152.

³² 42 U.S.C. § 1395w-4(m).

The Healthcare Act is a 974-page comprehensive law that will mandate many other changes to existing practices applicable to both companies and individuals, including certain tax and other reporting requirements. Its ultimate impact on industries, employers and individuals will be a topic of much discussion for many years to come.

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