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The Supreme Court Tackles Health Care Reform: What's at Stake for U.S. Businesses

Today, the Supreme Court will hear historic arguments[1] on several challenges to the constitutionality of the 2010 health care reform law, the Affordable Care Act (ACA or the Act).[2] The Court's decision could have major legal, economic and political consequences, including shaping the way health care is delivered and financed. There is little doubt that the Court's decision will color the November 2012 presidential election. This client alert provides an overview of the issues before the Court and an analysis of how its decision could affect employers, health insurers, health care providers and others.

Top-Line Summary

- The Supreme Court will separately address four issues relating to the ACA: (1) whether the Anti-Injunction Act bars the Court from considering the Act's constitutionality until taxes are paid under the Act; (2) whether the Act's individual mandate is within the scope of Congress' power; (3) whether, if the individual mandate is found to be unconstitutional, it can be severed from other provisions of the ACA; and (4) whether the Act's expansion of the Medicaid program creates an unconstitutional burden on the states.

- Many provisions of the Act have been implemented, but some of the most important provisions — including the individual mandate and expansion of Medicaid — have yet to take effect.

- The impact of the Court's decision will differ for various segments of the health care industry specifically, as well as for employers more generally. The health insurance industry has the most at stake, given the major investments that plans have made in anticipation of adding 30 million individuals to the insurance rolls and the potential for the Court to strike down the individual mandate but leave other insurance market reforms (*e.g.*, guarantee issue, community risk rating) intact.

- Hospitals and providers could be net losers if the Court strikes down the individual mandate (and/or related market reforms) but leaves the Act's cost-containment provisions in place. Partial repeal could be problematic for drug and device makers, too, which would face industrywide taxes without the expansion of coverage to provide more Americans with access to drugs and devices.

1 The Court will hear six hours of oral argument over three days — the most time allotted for oral arguments in decades.

2 Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 State. 119, as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

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Background on the Affordable Care Act

History

The ACA was enacted in March 2010 after contentious debates in both houses of Congress. Proponents of the Act argued it would dramatically reduce the number of uninsured Americans, improve the quality of health care and reduce the nation's health care bill through a variety of cost-containment and payment reforms. Critics of the ACA dismissed these claims, saying the combination of tax hikes, broad and vague regulatory mandates, and unproven payment models would drive up costs, hinder innovation and expand government control over health care while stifling more promising market-oriented reforms.

Implementation to Date

The two substantive issues before the Court — the constitutionality of the minimum coverage requirement (often called the individual mandate) and the expansion of Medicaid — have not yet been implemented. However, many other provisions of the Act have taken effect, either by operation of law or through rulemaking or other regulatory action. Examples of provisions that have taken effect or for which final regulations have been issued include:

- prohibiting individual and group health plans from placing lifetime limits on coverage, rescinding coverage except in cases of fraud and denying children coverage based on pre-existing medical conditions;
- increasing the Medicaid drug rebate percentage for brand-name drugs to 23.1 percent and generic drugs to 13 percent;
- requiring health plans to provide rebates to consumers if the share of the premium spent on clinical services and quality is less than 85 percent for large plans and 80 percent for individual and small group plans;
- establishing a Medicare hospital value-based purchasing program that pays hospitals based on performance against quality measures, and requiring plans to be developed to implement value-based purchasing programs for other provider types;
- reducing rebates paid to Medicare Advantage plans and providing bonus payments to high-quality plans;
- gradually reducing Medicare payments that would otherwise be made to hospitals to account for excess (preventable) hospital readmissions; and
- establishing rules governing the formation and operation of Accountable Care Organizations.

Many of the signature provisions of the Act, however, have yet to take effect. These include the individual mandate and expansion of Medicaid (the two substantive provisions before the Court, both of which are scheduled to take effect in 2014). If the Court upholds these provisions, the Act will be implemented as follows:

On or After January 1, 2013

- The amount of contributions to a flexible spending account for medical expenses will be limited to $2,500 per year, increased annually by the cost of living adjustment.

- Employers who receive Medicare Part D retiree drug subsidy payments will not be able to deduct those subsidies.
- An excise tax of 2.3 percent will be imposed on the sale of any taxable medical device.
- The Sunshine Act will be implemented, requiring disclosures by drug, device and medical supply manufacturers of payments to teaching hospitals and physicians.

On or After January 1, 2014

- Funding for the Children's Health Insurance Program (CHIP) will be extended.
- State-based American Health Benefit Exchanges and Small Business Health Options Program (SHOP) Exchanges will be created. These exchanges will be administered by a governmental agency or nonprofit organization and allow individuals and small businesses (up to 100 employees) to purchase qualified coverage.
- A fee of $2,000 per full-time employee, excluding the first 30 employees, will be assessed on employers with more than 50 employees that do not offer coverage and have at least one full-time employee who receives a premium tax credit. Employers with more than 50 employees that offer coverage but have at least one full-time employee receiving a premium tax credit will pay the lesser of $3,000 for each employee receiving a premium credit or $2,000 for each full-time employee, excluding the first 30 employees.
- The Independent Payment Advisory Board will submit its first annual report of legislative proposals to reduce the *per capita* rate of growth in Medicare spending (in the event that spending growth exceeds a target growth rate).

On or After January 1, 2016

- States will be permitted to form health care choice compacts that allow insurers to sell policies in any state participating in the compact.
- An excise tax will be imposed on insurers of employer-sponsored health plans with aggregate expenses that exceed $10,200 for individual coverage and $27,500 for family coverage.

Rulings by the Appellate Courts

The ACA has been challenged in a number of federal courts, in cases brought by states, institutions and individuals. In the cases before the Supreme Court (brought by the State of Florida and the National Federation of Independent Businesses), the district court upheld the expansion of Medicaid, but ruled that the individual mandate was unconstitutional and could not be severed, requiring the invalidation of the entire ACA. On appeal, the Eleventh Circuit agreed that the individual mandate was unconstitutional, but found that it could be severed from the remainder of the Act, including the Medicaid expansion (which the Eleventh Circuit also upheld). The other two federal appellate courts to address the merits of constitutional challenges to the ACA — the D.C. Circuit and the Sixth Circuit — disagreed with the Eleventh Circuit and upheld the individual mandate.

A number of other circuits have dismissed ACA challenges on procedural grounds: the Fourth Circuit found both that a challenge to the individual mandate brought by taxpayers was barred by the Anti-Injunction Act and that the State of Virginia lacked standing to challenge the individual mandate; the Third, Eighth and Ninth Circuits also have dismissed cases for lack of standing. ACA challenges pending in the Third, Fifth and Sixth Circuits have been stayed pending the Supreme Court's review.

Summary: Federal Circuit Court Decisions

Circuit	Standing	Individual Mandate	Medicaid Expansion	Anti-Injunction Act
DC		Upheld		
Third	No standing			
Fourth	No standing			Action Barred
Sixth		Upheld		
Eighth	No standing			
Ninth	No standing			
Eleventh		Struck down	Upheld	

Questions Before the Supreme Court

The Court has granted review on four questions, which have been briefed and will be argued separately.[3]

Anti-Injunction Act

On the first day of argument, the Court will consider whether the Anti-Injunction Act — which prohibits federal courts from ruling on a challenge to a federal tax until after the tax is paid and a refund requested — precludes the Court from considering the Act's constitutionality at this time. Under the Act's individual mandate, federal income taxpayers who fail to maintain a minimum level of health insurance coverage for themselves or their dependents will owe a penalty for each month in which such coverage is not maintained. The amount of penalty will be calculated as a percentage of household income, subject to both a floor and a cap. The penalty will be reported on the taxpayer's federal income tax return and will be assessed and collected by the IRS. However, no penalties will be assessed under the Act until 2015. Challengers to the ACA argue that they are not seeking to restrain the assessment or collection of penalties, but only the requirement for individuals to purchase insurance, and that the penalty is not a "tax." The United States agrees that the Anti-Injunction Act does not bar a decision at this time. To ensure that all views are considered, the Supreme Court appointed an attorney to argue in favor of the Anti-Injunction Act's applicability.

Individual Mandate

On the second day of argument, the Court will turn to the most fundamental issue before the Supreme Court: whether the individual mandate is within the scope of Congress' power either to regulate commerce among the states or to tax and spend for the general welfare.

As a general matter, Congress can act under the Commerce Clause in three circumstances: It can regulate the channels of interstate commerce; it can regulate the instrumentalities of interstate commerce; and it can regulate economic activities that, taken cumulatively, have a substantial effect on

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3 The order of argument is: Anti-Injunction Act (March 26), individual mandate (March 27), severability (March 27) and Medicaid expansion (March 28). The cases before the Court are: *Department of Health and Human Services v. Florida* (individual mandate and Anti-Injunction Act); *Florida v. Department of Health and Human Services* (severability and Medicaid expansion); and *National Federation of Independent Businesses v. Sebelius* (severability).

interstate commerce. *See Gonzalez v. Raich*, 545 U.S. 1, 16-17 (2005). In its decision striking down the individual mandate, the Eleventh Circuit held that individuals who choose not to purchase health insurance are not within commerce; rather, their actions are "marked by the absence of a commercial transaction." *Florida v. Dept. of Health & Human Servs.*, 648 F.3d 1235, 1285, 1307 n.126 (11th Cir. 2011). Supreme Court briefs submitted by the Obama administration and others counter that, because everyone in the United States will need health care at some point, everyone is engaged in economic activity either by self-insuring or purchasing insurance. Proponents of the ACA also argue, in the alternative, that the individual mandate may be upheld as a tax within Congress' power to tax and spend for the general welfare.

Severability

The Court also will consider whether other provisions of the ACA may stand if the individual mandate is declared unconstitutional. Although the Eleventh Circuit struck down the individual mandate, it ruled that other ACA provisions were independent and upheld them. The challenge to this position — which is supported by numerous amicus briefs from the health insurance and health care provider sectors — argues that the individual mandate is not severable because it is "the very heart of the act" and the Act would not have been adopted without it. The United States argues that two other provisions of the ACA would fall with the individual mandate, but that the remainder of the provisions should stand. The Supreme Court has appointed an attorney to argue that, if the mandate falls, all other provisions of the ACA should remain in place.

Medicaid Expansion

Finally, the Court will consider whether the Act's significant expansion of Medicaid eligibility creates an unconstitutional burden on the states in violation of Congress' power under the Spending Clause and the Tenth Amendment. The ACA requires the states to cover all persons with incomes up to 133 percent of the federal poverty level. The Act provides some additional federal funds for this expansion: The federal government will pay 100 percent of the cost of coverage of newly eligible individuals until 2016, and will gradually decrease its contribution to 90 percent in 2020.

What's at Stake for U.S. Business: A Sector-by-Sector Analysis

Given the complex and often interconnected provisions of the almost 1,000-page ACA, it is not possible to predict or identify clear winners and losers if the Supreme Court strikes down one or more provisions of the Act or remands the various challenges to the lower courts for further consideration. Nevertheless, some insights can be gleaned from the positions taken by trade associations during the legislative debate, amicus briefs submitted to the Court by dozens of trade associations and advocacy groups, and other sources.[4]

Employers: A decision to invalidate the entire ACA would have conflicting impacts on employers, depending on the size of the company. Invalidating the Act might be viewed as benefiting employers with more than 50 employees by removing the mandate (which will take effect on January 1, 2014) that such employers provide minimum coverage to all employees or pay a penalty for each employee who does not receive such coverage. A Court decision striking down the entire Act also would repeal the provision that eliminates the deduction for Medicare Part D retiree drug subsidy payments. At the same time, however, if the Act is struck down in its entirety, employers seeking to provide coverage

4 Skadden takes no position on the merits of the challenges to the ACA or the ACA itself. The analysis herein is derived largely from amicus briefs, congressional testimony and other public statements by representatives of the sectors described.

would lose access to the state-run health insurance exchanges, which are scheduled to be in operation by January 1, 2014. These exchanges are intended to provide employers and individuals with cheaper, easier access to insurance. Another provision of the Act that would be struck down allows states to enter into compacts and for insurers to offer policies across state lines. The ACA's proponents have argued that these compacts will reduce the cost of insurance for employers and individuals.

Health Insurers: Health insurers, by far, have the most at stake in the near term if the Court strikes down the Act in its entirety or invalidates the individual mandate (possibly along with related insurance market reform provisions). Some in the health insurance industry have argued that the worst possible outcome for insurers would be for the Court to uphold the Eleventh Circuit's decision, which struck down the individual mandate but found it severable from the rest of the ACA. Insurers have argued passionately during the ACA debates and in briefs to the Court that the only way to both expand coverage and keep premiums affordable is to increase the size of the risk pool to include relatively younger and healthier individuals who would otherwise forego purchasing health insurance.

Health insurers have also asserted that a decision invalidating the individual mandate and related health insurance market reforms would still be a net negative for the insurance industry.[5] Despite serious misgivings about many of the Act's provisions (*e.g.*, cuts in rates for Medicare Advantage plans and minimum medical loss ratios), many in the insurance industry viewed the ACA as a net positive. As enacted, the ACA trades some less-than-business-friendly costs and regulatory requirements for a dramatic expansion — most estimates are in the range of 30 million — in the number of newly insured, premium-paying individuals (many of whom will be supported by government subsidies). Moreover, the insurance industry far preferred the Act's basic mechanism for expanding insurance — through private insurance offerings under state-operated insurance exchanges — to the likely alternatives, including single-payer and similar models. Insurance companies already have invested substantial amounts in preparing for the operation of insurance exchanges; repeal of the entire ACA would, they have urged, make these investments a waste. Finally, health care reform appears to have been a catalyst for M&A activity in the health insurance and health system sectors over the past two years. While the long-term impact of a Supreme Court decision striking down the ACA in its entirety is impossible to predict, at the very least, insurers would face the loss of tens of millions of newly insured individuals beginning in 2014.

Hospitals and Institutional Providers: Institutional health care providers have argued that a decision to strike down all or part of the ACA would be, in the near term, an economic negative for many in that sector (*e.g.*, hospitals and health systems). While providers have expressed significant concern about the regulatory burden imposed on providers under the ACA and its implementing regulations, trade associations representing a wide variety of hospitals and other institutional providers have urged the Court to uphold the law. If left standing, the ACA would expand coverage for an estimated 30 million Americans, with the expansion funded in large part by significant increases in health care spending by the federal and state governments. Much of this money would flow to institutional providers. As a result, such providers generally supported the Act's trade-off of lower reimbursement

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5 Most of the key insurance market reforms relevant to the individual mandate are included in Section 1201 of the Act, which requires insurers to issue and renew health care coverage for applicants and enrollees who pay the premium ("guarantee issue" and "guaranteed renewability"), prohibits pre-existing condition exclusions, forbids insurers from basing coverage eligibility on health status and related factors (*e.g.*, presence of a disability), and prohibits insurers from imposing waiting periods longer than 90 days before an enrollee's coverage takes effect. The Act also institutes a modified "community rating" system, which precludes insurers from pricing policies according to health status and other types of information relating to an applicant's claims history, and limits premium variations based on applicants' ages, gender, geographic locations or tobacco use. Under the Act, all participants within a given risk pool pay the same premium for the same coverage.

rates and tougher regulatory requirements against a significant increase in the volume of insured individuals. In addition, institutional providers have devoted substantial effort and resources to expanding clinical capabilities, upgrading physical facilities and technology, and enhancing quality and performance programs, all in anticipation of the influx of more patients and the implementation of stricter clinical and quality standards. Should the Court strike down the ACA (particularly in its entirety), this industry sector has asserted that the payoff from these investments would be a long time in coming, if it is ever realized.

Drug and Device Manufacturers: Although drug and device manufacturers would appear to have much at stake if the ACA is struck down in whole or in part, the major trade associations representing these industries did not submit briefs regarding the ACA challenges now before the Court. During the legislative debate, the pharmaceutical industry reportedly struck an early deal with the Obama administration to support health care reform legislation — including agreeing to a broad tax on the pharmaceutical sector — in exchange for the administration's agreement not to push price controls or authority for Medicare to negotiate drug prices directly with manufacturers. Media reports suggest that the device industry pursued a different strategy, consistently opposing a device tax. For both industries, the lower reimbursement rates and/or rebates and new sector taxes ultimately included in the Act likely will be offset, at least in part, by the expected increase in the use of drugs and devices by the 30 million newly insured Americans who can be expected to purchase insurance beginning in 2014 pursuant to the individual mandate, if the ACA is upheld.

If the ACA is struck down entirely, drug manufacturers would face: elimination of the industry-wide tax, repeal of increased Medicaid rebates, repeal of the provisions to lower and eventually eliminate the Medicare Part D coverage gap (the "donut hole"), repeal of the FDA's enhanced authority to approve generic biologics, repeal of the expanded definition of 340B entities (which receive favorable pricing from manufacturers), and repeal of the requirement for manufacturers to disclose publicly payments to health care providers (the Sunshine Act).

The number of ACA provisions affecting device manufacturers is smaller, yet the provisions arguably are no less significant. They include repeal of the 2.3 percent excise tax on all medical devices, repeal of the Sunshine Act reporting requirements and repeal of the various Medicare payment reform mechanisms that would have an important, if indirect, impact on medical device companies.

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Regardless of the industry sector, a decision to strike down the ACA would have significant legal, regulatory and economic implications for sectors across the American health care industry. It is safe to assume, in this election year and given the debate that surrounded the passage of the ACA, that Congress and the president would not act to address any Court decision before the November 2012 election. The prospects post-election would depend on the outcome of the presidential and congressional elections. Absent a sweep of the White House and Congress by a single party (including a veto-proof majority in the Senate), all clients should expect that any congressional effort to address a Court decision to strike down all or parts of the Act would be lengthy and contentious, and the outcome would be all but impossible to predict. Some businesses may be optimistic that a more business-friendly and market-oriented law would result from a decision against the Act. Others might adopt a more pessimistic view that helpful reforms would be unlikely to pass in the gridlock that now seems to grip Washington. Either way, the health care industry specifically — and U.S. employers and businesses more generally — have much at stake as the Supreme Court considers the constitutional challenges to the ACA.