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How Big Is *Halbig*? The Potential Effects of This Major Ruling Are Numerous and Significant

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On July 22, 2014, the U.S. Court of Appeals for the D.C. Circuit and the U.S. Court of Appeals for the Fourth Circuit issued conflicting opinions on a key aspect of the Affordable Care Act ("ACA"). The cases are *Halbig v. Burwell*, D.C. Cir., No. 14-508, and *King v. Burwell*, 4th Cir., No. 14-1158. The question at issue in both cases was whether the IRS has the authority to administer subsidies in federally-facilitated exchanges when the statute itself specifically authorizes subsides only in state exchanges.

The ACA and the IRS's Regulation for Federally-Facilitated and State-Established Exchanges

According to the statutory text of the ACA, the penalties under the employer mandate are triggered only if an employee receives a subsidy to purchase coverage "through an Exchange established by the State under section 1311" of the ACA. If a state elected not to establish an exchange or was unable to establish an operational exchange by January 1, 2014, the Secretary of Health and Human Services was required to establish a federal exchange under section 1321 of the ACA.

In 2012, the IRS promulgated regulations making subsidies available in both federally-facilitated exchanges and state-run exchanges. In those regulations, the IRS asserted that "the statutory language … and other provisions" of the ACA "support the interpretation" that credits are available to taxpayers who obtain coverage through both state and federally-facilitated exchanges.

The Court Challenges

The individuals and employers who brought the suits live or employ individuals in states that did not establish their own exchanges. They argue that the text of the ACA is clear and unambiguous: the IRS does not have the authority to administer subsidies in their states because the exchanges were not "established by the State."

In *Halbig v. Burwell*, a panel of the D.C. Circuit, in a 2-1 decision, agreed with the appellants and vacated the IRS regulation. The court focused heavily on the plain meaning of the statutory text and concluded "that the ACA unambiguously restricts the ... subsidy to insurance purchased on Exchanges established by the state." In an opinion issued only hours later, the Fourth Circuit, in a 3-0 decision in *King v. Burwell,* went the other way, finding the statutory language ambiguous. Accordingly, the Fourth Circuit upheld the subsidies "as a permissive exercise of the agency's discretion."

Given the circuit court split, many commentators believe that Supreme Court review will be necessary to resolve this issue. However, while it is certainly possible, perhaps even likely, that the Supreme Court will grant a petition for certiorari, it may not be a foregone conclusion. The Obama administration has already indicated that it will seek *en banc* review of the *Halbig* decision by the entire D.C. Circuit. If the full D.C. Circuit were to reverse the *Halbig* panel decision, the existing "circuit split" would be resolved, potentially making Supreme Court review less likely. If decided in favor of the challengers, similar cases pending in district courts in the Tenth and Seventh Circuits could create a circuit split even if the full D.C. Circuit reverses *Halbig*.

On the other hand, given the tremendous importance of this issue to the operation of the ACA and the fact that the IRS regulation allows tax credits arguably without the authorization of Congress, the Supreme Court may accept review to fully settle this important question of federal law, regardless of whether there are conflicting decisions from the circuit courts. The Supreme Court has long operated under the "rule of four," a convention under which a grant of certiorari requires the approval of only four justices. Given the fact that the availability of the subsidies is an issue of national importance and that, two years ago, four justices voted to strike down the ACA altogether, Supreme Court review of this issue appears likely. Ultimately, however, whether the Supreme Court will accept the case is a matter of speculation.

Potential Impact of *Halbig* on the Employer and Individual Mandates

For employers, the most significant issue may be the potential impact that the *Halbig* ruling could have on the employer mandate. As noted above, the employer mandate penalties are only triggered by an employee going to the exchanges and purchasing subsidized health benefits. Accordingly, if none of its employees is allowed a subsidy, then no penalties would be triggered against an employer. Thus, for employers with employees in the more than 30 states with federally-facilitated exchanges,[1] the question that arises is how the *Halbig* ruling should impact their decision and strategy to provide health coverage to their employees when the employer mandate takes effect in 2015 (or 2016 for employers with 50-99 employees). If *Halbig* stands, applicable large employers

[1] There is a slight disagreement as to the number of exchanges established by states. *Halbig* found that "only fourteen states and the District of Columbia have established exchanges. The federal government has established exchanges in the remaining thirty-six states, in some cases with state assistance but in most cases not." In contrast, *King* states, "Only sixteen states plus the District of Columbia have elected to set up their own Exchanges; the remaining thirty-four states rely on federally-facilitated Exchanges."

in the states with federally-facilitated exchanges to whom the employer mandate would otherwise apply may be freed from its penalties.

Additionally, considering that the employer mandate and its penalty provisions have been delayed twice before and have not yet taken effect, this legal development could provide employers and trade associations with an opportunity to ask the Obama administration to delay the employer mandate yet again until the Supreme Court has a chance to review the case, or even to eliminate the employer mandate altogether.

For individuals, the impact of the *Halbig* ruling is mixed. While many individuals stand to lose access to subsidies, the current availability of those subsidies in the states with federally-facilitated exchanges gives the individual mandate a broader effect than it otherwise would have. Because the individual mandate penalty does not apply to individuals for whom the cost of the cheapest available coverage exceeds 8 percent of their income, the availability of credits increases significantly the number of individuals who must purchase health benefits or face a penalty.

Potential Impact of *Halbig* on the Exchanges and Qualified Health Plans

In addition to the mandates, it is important to consider the impact of the decision on the exchanges and the qualified health plans ("QHPs") that are currently offered on the exchanges.

Since the *Halbig* decision is stayed for one week pending a determination as to whether the full D.C. Circuit will hear the case *en banc,* there is no obvious immediate impact; the exchanges will continue to evaluate requests for subsidies and to grant them where appropriate, and the QHPs will continue to enroll individuals based on the premise that the premium will be paid, in part, by the subsidy. The QHPs will also continue to issue "plan variations," that is, plans that implement the cost-sharing subsidies for eligible members by reducing their obligations for deductibles and co-insurance in return for pre-payment of the expected amounts by the exchange.

In the event that it is ultimately determined that the subsidies may not be offered to persons obtaining coverage through the federal exchange, one question to consider is whether the decision would have a retroactive impact. Although this would not seem likely, if the subsidies are unlawful and should not have been provided in the first instance, the government could seek reimbursement of the prior subsidies paid, either from the health plans or the members. Such an effort would likely be challenged, and, given the potential bad press and financial consequences for low income individuals and health plans, retroactive retraction does not seem likely.

More importantly, without the availability of subsidies, it seems likely that the exchanges and the QHPs would have very little enrollment. According to reported statistics, 85 percent of the individuals enrolled in the marketplace overall (state and federal) are receiving financial assistance.[2] If 85 percent of the enrollment were terminated, it would seem that the ongoing operations and viability of the program would be in jeopardy.

[2] ASPE Marketplace Summary, Department of Health and Human Services, May 1, 2014.

On the other hand, the states currently relying on the federal government to operate their exchange might be able to remedy the problem by establishing their own exchanges. There are three possible types of exchanges; besides the federally-facilitated exchange and the state exchange, there is also a “partnership exchange,” where a state agrees to perform some of the exchange functions and the federal government performs the remaining ones. As noted earlier, the *Halbig* decision seems to indicate that a partnership exchange does not constitute an exchange established by the state, but *King* suggests otherwise. Accordingly, until definitively settled, it could be argued that persons enrolling in these exchanges are enrolling in an exchange established by the state and, therefore, qualify for the subsidies. This construct could allow the state to establish an exchange more quickly than it could on its own.

Short term, it is not clear whether the uncertainty will cause QHPs to withdraw from the market if they are already offering products on the exchange or if some of the new applicants will back off and await the outcome of these decisions.

Impact of *Halbig* on Cost-Sharing Subsidies

Halbig only addressed the tax credits to facilitate the purchase of health insurance; nevertheless, the availability of cost-sharing subsidies also will be adversely affected by this decision. Eligibility for cost-sharing subsidies is tied to a person's eligibility for tax credits under the ACA and corresponding regulations. The connection between the tax credits and the cost-sharing subsidies derives from 42 U.S.C. § 18071(f)(2) (added by section 1402 of the ACA), which states that “no cost-sharing reduction shall be allowed under this section with respect to coverage for any month unless the month is a coverage month with respect to which a credit is allowed to the insured (or an applicable taxpayer on behalf of the insured) under section 30B of such Code.” “Section 36B” refers to 26 U.S.C. § 36B, which governs premium tax credits and was added by section 1401 of the ACA. Essentially, this means that, if an individual is not entitled to a premium tax credit, he or she cannot be eligible for a cost-sharing subsidy.

Likewise, the regulations condition cost-sharing subsidy eligibility on premium tax credit eligibility in 45 C.F.R. § 155.305(g). The definition of “Exchange” is “a governmental agency or non-profit entity that meets the applicable standards of this part and makes QHPs available to qualified individuals and qualified employers. Unless otherwise identified, this term refers to State Exchanges, regional Exchanges, subsidiary Exchanges, and a Federally-facilitated Exchange.” Notably, the IRS regulations governing the premium tax credit cross-reference this definition.

Stay Tuned

More questions are sure to arise as the two conflicting court decisions work their way towards ultimate resolution. At this point, one thing is clear: these decisions will not be the final word on this issue.

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