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Challenges to IRS Regulations Allowing Subsidies in Federally-Established Exchanges Under the ACA: Federal Court Rulings Are Expected Soon

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Challenges to federal health reform implementation continue to make their way through the federal courts, with court rulings expected shortly. Employers are especially advised to monitor challenges to the federal regulations that authorized the federally facilitated exchanges ("FFEs") to distribute tax credits and copayment subsidies (collectively "subsidies") to eligible persons.

By way of background, it was nearly two years ago when the U.S. Supreme Court ruled that the individual mandate at the heart of the Patient Protection and Affordable Care Act (ACA) could be construed as a tax, although it violated the Commerce Clause. Consequently, the U.S. Supreme Court upheld the health insurance reforms in the ACA on that basis. Most employers thought that ruling settled the controversy over the implementation of the health insurance reforms in the ACA. However, numerous legal challenges to the ACA have continued to make their way through the federal courts. For example, numerous employers challenged the law's contraception mandate, on religious liberty grounds. A Supreme Court ruling on that issue is expected by the end of June 2014.

In addition, there are currently pending in federal courts at least four legal challenges to the federal government's regulation that authorized the distribution of subsidies for the purchase of health insurance through the FFEs established by the Department of Health and Human Services (HHS). Rulings in one or more of these cases could come down at any time. The four cases each challenge the HHS' and Internal Revenue Services' (IRS) ability to implement the ACA's subsidies and employer mandate penalties in the 36 states with FFEs.

The employer mandate applies to any employer with 50 or more full-time employees or full-time equivalents. The employer mandate requires an "applicable large employer" to offer its full-time employees "affordable" health coverage providing "minimum value" mandated under the ACA, or else pay a fine of up to two thousand dollars per full-time employee. However, the penalties under the employer mandate are operative against a

particular employer only if an employee receives a subsidy for her purchase of insurance "through an Exchange *established by the State under section 1311* of the" ACA. 26 USC § 36B(c)(2)(A)(i) (emphasis added).

Those two clauses – "established by the State" and "under section 1311" are central to the legal challenges currently working their way through the federal courts on this particular issue. This is because HHS – through HealthCare.Gov – established the FFEs currently in use in 36 states, and it did so under section 1321 of the ACA, not under section 1311 of the ACA. Section 1321 of the ACA requires HHS to "establish and operate such Exchange within the State" if a state is "not an electing State" or if HHS determined "on or before January 1, 2013," that the state "will not have any required Exchange operational by January 1, 2014[.]" Thirty-four states elected not to establish their own exchanges, and two additional states could not get their exchanges operational in time. Thus, HHS, and not the states, established the health insurance exchanges currently operating in 36 states.

The plaintiffs in the four cases reside in or run businesses in states that did not establish their own exchanges. According to the plaintiffs, no subsidies are authorized in the FFEs, because the ACA authorizes federal subsidies only to those individuals who enrolled in a qualified health plan "through an Exchange established by the State."

Notwithstanding the statutory language of the ACA, in 2012 the IRS issued federal regulations purporting to authorize such subsidies in all states, including those states that failed to establish exchanges and where the federal government had established the FFE. The IRS regulations define "Exchange" as "an Exchange serving the individual market for qualified individuals … *regardless of whether the Exchange is established by a State … or by HHS*." The IRS regulations also state that subsidies will be available to anyone "enrolled in one or more qualified health plans through an Exchange[.]" Consequently, as a result of the IRS regulations, subsidies are available in all states, whether the exchange was established by the state or HHS, and whether it was established under section 1311 or under section 1321.

The four ongoing lawsuits challenge the authority of the IRS to authorize such subsidies contrary to the statutory text of the ACA, in states where the federal government established the FFE. Should the plaintiffs succeed in any of the cases, then no subsidies would be available to individuals in the relevant states in which HHS established the FFE.

For employers, the primary consequence would be the inapplicability of the employer mandate in their state. As stated above, the receipt of a subsidy by an employee is the "trigger" for the employer mandate's penalty, so if no employees may qualify for a subsidy because the state had failed to establish an exchange, then the employer mandate's penalty will be prevented from taking effect in that state. Accordingly, employers in such states could offer non-compliant coverage—or fail to offer coverage at all—and not be subject to any penalties that arise under the employer mandate in the ACA.

In light of the importance of these cases, the issue is likely to end up before the U.S. Supreme Court, perhaps as soon as next term. Two of the cases have already been argued before federal circuit courts of appeal. The case most likely to reach the Supreme Court (by virtue of being the furthest along) may be *Halbig v. Sebelius,* which was argued before the U.S. Court of Appeals for the D.C. Circuit in late March. It is likely that the D.C. Circuit will issue a ruling soon.

Courts are often hard to read, but some comments from the three *Halbig* panel judges are intriguing. At the oral argument, Judge Edwards appeared to favor the IRS' position, calling the plaintiff's argument "preposterous." On the other hand, Judge Randolph made statements that show he may believe that the plain meaning of the ACA prohibited the IRS' regulations. The judge who might tip the balance is Judge Griffith, who made several key comments suggesting that he might rule in favor of the plaintiffs.

For instance, the following exchange occurred between Judge Griffith and Stuart Delery, the attorney for the government. After noting that one of the plaintiffs was from the state of West Virgina, Judge Griffith asked:

JUDGE GRIFFITH:	[W]ho established the exchange in West Virginia? Who?
MR. DELERY:	The Secretary.
JUDGE GRIFFITH:	The Secretary established the exchange.
MR. DELERY:	Right.
JUDGE GRIFFITH:	West Virginia did not establish the exchange.
MR. DELERY:	That's correct, Your Honor.

After these statements, Judge Griffith noted that the question before the court was not the type of exchange, but rather "who established it." He noted that "[a]pparently, that phrase meant a lot to Congress" and told the government's attorney that "by your own admission the Secretary established it." Accordingly, Judge Griffith seemed that he might be amenable to the plaintiffs' arguments.

If the D.C. Circuit invalidates the IRS regulations, there is the potential for an *en banc* review by the full appellate court, followed by a near-certain appeal to the U.S. Supreme Court. There also is a possibility that different courts will reach different outcomes. For instance, the Fourth Circuit Court of Appeals will be deciding this issue as well. Split decisions among the various circuit courts will make the issue even more likely to be reviewed by the Supreme Court. Where the Supreme Court might come out is anybody's guess, although in contrast to the ACA's first go-round before that tribunal, *Halbig* would present a far less complicated case, dealing with statutory interpretation rather than constitutional bounds.

If the Supreme Court accepts review, there is reason to believe that a majority of the justices could ultimately vacate the IRS regulations authorizing subsidies. If the Supreme Court were to strike down the IRS regulations, states could establish state-based exchanges in an attempt to become ACA-compliant and to qualify for the

established subsidies. At this time, a legislative "fix" in Congress appears unlikely, as it is doubtful that congressional Republicans would change the law to allow subsides in FFEs.

Given the recent actions by the Obama administration to delay the implementation of the employer mandate and its related penalties, originally set to take effect in 2014, to 2015 for employers with 100 or more full-time equivalent employees and 2016 for employers with 50 to 99 such employees, there are many employers for whom the outcome of this issue may prove quite significant. In the meantime, employers should remain vigilant in their efforts to comply with the health insurance reform provisions of the ACA while considering how this issue could impact their strategic compliance decisions.

Employers, stay tuned!

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