Supreme Court Upholds Premium Subsidies in 34 States with Federally-Facilitated Marketplaces

June 25, 2015

Today the U.S. Supreme Court handed down its much anticipated decision in King v. Burwell, a case challenging the legality of Federal subsidies provided to individuals in the 34 States that did not establish State-based American Health Benefit Exchanges (“State Exchanges”), and instead provide individual marketplace coverage through “Federally-facilitated Exchanges.”1

In a 6-3 decision (Roberts, Kennedy, Ginsburg, Breyer, Sotomayor and Kagan), the Supreme Court upheld a key interpretation of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act, Pub. L. No. 111-152, 124 Stat. 1029 (2010) (“ACA”). In the second opinion authored by Chief Justice Roberts in a judicial challenge to the ACA, the Court held that individuals in States where the Federal government operates health insurance Exchanges are eligible for subsidies that help them purchase insurance through the Exchanges.2

It had been speculated that the invalidation of premium subsidies in States operating Federally-facilitated Exchanges would have caused millions of people with subsidized ACA health insurance to drop their coverage, causing serious disruptions in State insurance marketplaces.

Significantly, today’s decision could pave the way for formal merger agreements involving the nation’s major insurers, which some analysts believed were on hold pending the outcome of the case.3 On the other hand, while the ACA has been identified as a factor driving revenue growth in the sector, Exchange business represents a relatively small portion of overall profitability of publicly-


2 Slip op. at 4. Justice Roberts also authored the opinion in National Federation of Independent Business v. Sebelius, 132 S.Ct. 2566 (2012), which upheld the ACA’s “individual mandate” as a constitutional exercise of Congress’ taxing power, but found the Medicaid expansion provision of the ACA to violate the Constitution by threatening States with the loss of their existing Medicaid funding if they declined to comply with the expansion.

traded insurance companies. The stock prices of hospitals, which were expected to be the most adversely impacted by an invalidation of subsidies, rose in the wake of today’s decision.

At issue in King v. Burwell was the interpretation of Section 1401(a) of the ACA, codified as Section 36B of the Internal Revenue Code, which provides for premium tax credits to qualified taxpayers to defray the cost of individual health coverage for qualified health plans offered “through an Exchange established by [a] State under 1311 of the [ACA]” to comply with the ACA’s “individual mandate” requiring individuals to obtain “minimum essential coverage” effective January 1, 2014. The Internal Revenue Service (“IRS”) promulgated regulations interpreting the term “Exchange” for the purpose of 26 U.S.C. § 36B to cover both State Exchanges and Federally-facilitated Exchanges, finding that the language of Section 36B and other provisions of the ACA “support the interpretation that credits are available to taxpayers who obtain coverage through a State Exchange . . . and the Federally-facilitated Exchange” and that “the relevant legislative history does not demonstrate that Congress intended to limit the premium tax credit to State Exchanges.”

Sixteen States and the District of Columbia operate State Exchanges, and 34 States participate in Federally-facilitated Exchanges, including seven States (Arkansas, Delaware, Illinois, Iowa, Michigan, New Hampshire and West Virginia) which participate in State Partnership Exchanges approved by the U.S. Department of Health and Human Services (“HHS”) in which States assume primary responsibility for carrying out certain activities in the Federally-facilitated Exchange related to plan management, consumer assistance and outreach, or both.

On November 7, 2014, the Supreme Court granted certiorari in King v. Burwell after two Federal Courts of Appeals reached opposite conclusions when considering whether the IRS exceeded its authority in promulgating the regulations extending premium tax credits under the ACA to both

---


5 For example, according to stock quotes published in the Wall Street Journal, HCA Holdings was up 8.82% and Tenet Healthcare Corp. was up 12.24% for the day.


7 26 C.F.R. § 1.36B-1; 45 C.F.R. § 155.20; 77 Fed. Reg. 30,377, 30,378 (2012). Section 1311 of the ACA, codified at 42 U.S.C. § 18031, requires each State, no later than January 1, 2014, to establish an “American Health Benefit Exchange” that “facilitates the purchase of qualified health plans,” and meets certain statutory requirements. Such State-established exchanges are referred to as “State Exchanges.” Section 1321 of the ACA, codified at 42 U.S.C. § 18041, authorizes the Secretary of HHS, directly or through a not-for-profit entity, to establish a “Federally-facilitated Exchange” in any State where a State Exchange is not operating. See also 45 C.F.R. § 155.20 (defining “Federally-facilitated Exchange” as “an Exchange established and operated within a State by the Secretary under section 1321(c)(1) of the [ACA].”)

State and Federal Exchanges. Oral argument occurred on March 4, 2015. The petitioners, four Virginia citizens who claimed they did not want to purchase health insurance and would be exempt from the “individual mandate” tax penalty if Federal subsidies did not make health insurance coverage affordable in their State, argued that the IRS regulations granting subsidies for coverage purchased through all Exchanges contradicts the text of Section 1401(a) restricting subsidies to Exchanges “established by the State” under Section 1311 of the ACA. In contrast, the Federal government argued that the premium subsidies are central to the goals of the ACA and supported by the context of the statute. The Court sided with the Federal government, holding that “Section 36B [of the Internal Revenue Code] allows tax credits for insurance purchased on any Exchange created under the [ACA].” The Court reasoned that, when read in context, “the phrase ‘an Exchange established by the State’ . . . is properly viewed as ambiguous” and could refer to “all Exchanges—both State and Federal—at least for purposes of tax credits.” The Court then turned to the “broader structure of the Act” and determined that the “statutory scheme compels the Court to reject petitioners’ interpretation because it would destabilize the individual insurance market in any State with a Federal Exchange” and lead to the “type of calamitous result that Congress plainly meant to avoid.”

The Court’s decision avoids what some commentators had feared would be an adverse selection “death spiral.” The vast majority of Exchange enrollees benefit from premium assistance. According to a February 2015 HHS research brief, 87 percent of enrollees in Federally-facilitated Exchanges had received a premium tax credit. Without the subsidy, it was feared that many of the 6.4 million enrollees in Federally-facilitated Exchanges who currently rely on subsidies would have

---

9 On July 22, 2014, the Fourth Circuit in King v. Burwell, 759 F.3d 358 (4th Cir. 2014), determined that the IRS had not exceeded its authority. On the same date, the United States Court of Appeals for the District of Columbia Circuit reached the opposite conclusion in Halbig v. Burwell, 758 F.3d 390 (D.C. Cir. 2014), finding the IRS regulation to be contrary to the clear language of the statute. On September 4, 2014, the Court of Appeals for the District of Columbia agreed to rehear the case en banc, vacating the previous judgment. On November 12, 2014, the U.S. Supreme Court granted certiorari in King, after which the Halbig court issued an order holding the case in abeyance pending the Supreme Court’s decision.


11 The Respondents in the case are Sylvia Mathews Burwell, as U.S. Secretary of HHS, Jacob Lew, as U.S. Secretary of the Treasury and John Koskinen, as Commissioner of Internal Revenue.


13 Slip op. at 21.

14 Slip op. at 12-13.

15 Slip op. at 15.

16 Slip op. at 21.

lost their insurance, forcing insurers to raise premiums to cover the cost of caring for higher-needs, higher-costs individuals more likely to retain coverage.\textsuperscript{18} Insurance premiums in the individual market could have surged by as much as 47% by some estimates, potentially causing additional enrollees to drop coverage.\textsuperscript{19}

Such an outcome would have impacted health care providers, particularly hospitals, which could have seen a reversal of financial gains experienced from having a greater number of insured patients, together with more unpaid medical bills and charity care requests.\textsuperscript{20} Some analysts predicted that stock prices of publicly-traded hospitals could rally as much as 8% as a result of a Supreme Court decision upholding subsidies.\textsuperscript{21} This prediction had been exceeded for some hospital companies by the close of market today.

Invalidation of subsidies in Federal Exchanges would have also threatened the “individual” and “employer mandates.” It had been estimated that the elimination of subsidies would have caused 83% of formerly subsidy-eligible individuals to become exempt from the ACA’s “individual mandate” penalty because the cost of insurance would have exceeded 8% of their income.\textsuperscript{22} With the penalty removed, these individuals would have had less incentive to maintain insurance. It had also been speculated that the invalidation of subsidies would have enabled employers in Federally-facilitated Exchange States to offer non-compliant coverage or no coverage without being threatened with the imposition of “assessable payments.” This is because the eligibility of an employer’s employees for the Federal premium tax credit triggers the “assessable payments” penalty that applies to “applicable large employers” if they do not offer full-time employees and their dependents the opportunity to enroll in “minimum essential” employer-sponsored health care coverage that is both “affordable” and provides “minimum value.” The penalty is only triggered when at least one full-time employee purchases coverage through an Exchange for which “an applicable premium tax credit or cost-sharing reduction is allowed or paid.”\textsuperscript{23}


\textsuperscript{21} Cristin Flanagan, Preview: Hospitals Seen at Risk Ahead of Ruling on Tax Subsidies, Bloomberg Law (June 22, 2015).


\textsuperscript{23} 26 U.S.C. § 4980H. Generally, an individual is eligible for a “premium tax credit” to purchase coverage through an Exchange only if the individual household income is less than 400 percent of the poverty level and the individual is not eligible to enroll in an affordable employer-sponsored health care plan that is considered “minimum essential coverage” and provides “minimum value.” Treas. Reg. § 36B-2.
The Court’s validation of the IRS rule means that subsidies will continue to be administered through all Exchanges – both State and Federally-facilitated. This maintains the status quo, as, despite the disagreement among the Federal Courts of Appeals, the IRS rule authorizing premium subsidies in all Exchanges has remained in effect throughout the Supreme Court litigation.

A number of other cases challenging other aspects of the ACA or its implementation are still pending in Federal Courts. While today’s decision does not affect those cases directly, it could make courts less receptive to such challenges. That said, many of the major Republican candidates for the 2016 presidential election oppose the ACA, and some have promised to repeal or replace it. Thus, despite President Obama’s pronouncement following the decision that “the Affordable Care Act is here to stay,” the long term future of at least certain aspects of the ACA remains unclear.

If you have any questions, please contact any of the following attorneys or your Cadwalader contact:

Paul W. Mourning  +1 212 504 6216  paul.mourning@cwt.com
Pamela Landman  +1 212 504 6104  pamela.landman@cwt.com
Stephanie Marcantonio  +1 212 504 6749  stephanie.marcantonio@cwt.com
Christina T. Holder  +1 212 504 6330  christina.holder@cwt.com

---