Potential ACA Glitch: The Other Legal Challenge
Worth Watching

Highlights

• Lawsuits challenging whether premium tax credits can flow through federally facilitated exchanges have the potential to virtually gut the ACA if successful. In *Pruitt v. Sebelius*, Oklahoma Attorney General Scott Pruitt argues that the IRS acted illegally when it chose to make subsidies broadly available through state and federal exchanges because the statute only authorizes subsidies for state established exchanges.

• Following the 2012 Supreme Court decision, investors may not be paying attention to these latest challenges, but the stakes are high and the legal arguments may have some merit. If successful, the challenges could stop the government from providing subsidies in the 33 states that are defaulting to a federal exchange, and effectively kill the employer mandate in those states as well.

• If these cases should make their way to the Supreme Court, a pure reading of the law may not matter as much as what Chief Justice Roberts thinks, and he may not be willing to dismantle a law that has been previously upheld or that has likely already gone into effect. If we learned one lesson from last year's ruling, it's that it's a fool's errand to predict how the courts might rule on ACA cases.

• We discuss in further detail the legal arguments for and against the cases, whether the glitch was a drafting error or intentional design, how the courts might analyze the case, and possible jurisdictional barriers.

Although the Supreme Court upheld the Affordable Care Act (ACA) in June of 2012, the law continues to face legal challenges. For instance, there are lawsuits challenging the ACA contraception coverage mandate, the employer mandate, and some of the Medicare provisions, such as the controversial IPAB (Independent Payment Advisory Board).

One lawsuit - challenging whether premium tax credits can flow through federally-facilitated exchanges - is of particular interest because it has the potential to virtually gut the ACA if it succeeds. It stems from statutory text stating that premium tax credits can be provided through state-based exchanges, but not federally-facilitated exchanges (FFE). This conflicts with what supporters of the ACA say was their intent. With only 17 states adopting a state exchange, the legal challenge, if successful, would practically derail exchanges in the 33 states that are defaulting to an FFE.
Outlook

If we learned one thing from Supreme Court ruling on the ACA last year, it’s that it’s a fool’s errand to predict how the courts may rule on an ACA case. If these cases should wind their way to the Supreme Court, a pure reading of the law may not matter as much as what Chief Justice Roberts thinks. He has signaled he values the court’s reputation and his legacy at the helm, and thus may not be willing to dismantle a law that it has already upheld.

As for timing, both cases are still at the district court level, with no rulings yet on merits. The government has filed a motion to dismiss the Oklahoma suit, and there was a hearing in June, but there has not been a ruling yet. Even if these suits overcome jurisdictional roadblocks, they are unlikely to be resolved before exchanges and subsidies go into effect in January 2014. The courts may be less inclined to overturn a major portion of the law that has already gone into effect, in our view.

The Legal Details

Without diving too far into the legal weeds, Case Western Reserve University’s Jonathan Adler and Cato Institute’s Michael Cannon have advanced a legal argument that the ACA authorizes premium subsidies for state exchanges, but not federal exchanges. Section 1311 of the ACA provides for states to establish an exchange, and Section 1321 provides that the federal government shall set up a federally run exchange where a state does not set up such an exchange. Section 1401 establishes subsidies for persons who are enrolled in a qualified health plan through a state-based exchange. However, there is no parallel subsidy provision anywhere in the ACA for persons who are enrolled in a plan through exchange established by the federal government pursuant to Section 1321. Cannon and Adler further argue that there is no other provision in the statute or in the legislative history that would contradict the plain reading of the provisions.

Cannon and Adler therefore assert that the IRS acted illegally when it issued regulations on August 17, 2011 to implement premium tax credits through federal exchanges. In the guidance, the IRS cites no specific authority for authorizing subsidies through federal exchanges. Further, they contend that since the receipt of tax credits triggers tax penalties against employers, the IRS is exceeding its delegated authority by authorizing a new tax. This could get a court’s attention since the IRS is typically very careful not to exceed the authority delegated by statute. It certainly has attracted attention from House oversight committees.

Adler and Cannon’s in-depth legal analysis can be found here: “Taxation Without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA.”

Oklahoma Litigation

The State of Oklahoma on September 19th filed a complaint, Pruitt v. Sebelius, against the IRS, arguing that the agency acted beyond the authority granted by the ACA. The suit states that IRS chose to make subsidies broadly available through state and federal exchanges, and as a result, the agency is imposing a tax on employers in states like Oklahoma that chose not to establish a state exchange.

The Oklahoma complaint specifically sues the IRS for violation of the Administrative Procedures Act, which prevents an agency from exercising powers which have not been
granted to them. This is the second lawsuit Oklahoma has pursued. An earlier suit challenging the employer mandate directly was dismissed. There is a separate case, *Halbig v. Sebelius*, that makes a similar argument in a DC court.

**The Counter Argument**

ACA proponents dismiss, even scoff at those who have advanced this legal challenge. Although they acknowledge that the law is not a model of clear legislative drafting, they assert that Congress clearly intended for subsidies and credits to be available in all exchanges. And many Congressional supporters of the ACA back this claim, though they have had a difficult time producing supporting documentation from the legislative statute and history. In other words, ACA proponents argue that Congressional intent is clear, even if Congress did not clearly state its intent.

In addition, Timothy Jost, a legal scholar and ACA proponent, points to what he claims is conflicting text in the statute. For instance, in a provision pertaining to states that fail to establish exchanges, it says “the Secretary shall…. establish and operate such exchange within the State.” Jost argues that “such” exchange means “required exchange” under the relevant Section 1311. Further, he cites a provision that requires exchanges to report information on premium assistance, asserting that it shows that Congress intended to provide subsidies through federal exchanges, or at least that there is some ambiguity.

**Drafting Goof or Hubris?**

ACA proponents argue that the missing language is merely a drafting error that should be overlooked. When there is conflicting language, the courts often give agencies deference to provide reasonable interpretations of ambiguous text. If the court buys the drafting error argument, it would presumably allow the IRS’s interpretation to stand.

However, ACA opponents argue that this was no drafting error. They assert that the Senate (it was the Senate’s version of the legislation that became law via the reconciliation process) intended for premium subsidies to only flow through state exchanges as an incentive, or even a condition, to coerce states to establish their own exchanges.

Indeed ACA proponents from the beginning confidently asserted that most states would want to establish their own exchanges so as not to relinquish control of their insurance markets. But not everyone saw it this way. Twenty one states sued to overturn the law, and now 33 states are defaulting a federally-facilitated exchange in 2014. The administration clearly did not expect to be running 33 exchanges in 2014. But whether Congress just made a drafting error or this was an intentional feature of the bill brought on by overly confident authors, will probably have to be decided by the courts.

**Plain Text and Legislative History**

Courts will typically look first to the statute, then to legislative history if there are any conflicts or ambiguities in the law. Legislative history can refer to documents supporting the statute, such as committee reports, floor speeches, and hearing records. If Adler and Cannon are right, there may not be much in the history to support Congressional intent to funnel tax credits through federal exchanges. But analyzing legislative history can be a potentially subjective process, and there will certainly be loud
voices arguing that Congress intended credits to flow through all exchanges, if this case gets heard on its merits.

A plain reading of the text does seem to support the legal challenge, in our view. Less clear is whether the legislative history contradicts the plain reading. Some legal scholars have pointed to CBO estimates of the law, which assume the availability of credits in all exchanges, as a strong statement of legislative intent. We don’t know if a court would consider CBO analysis as legislative history. Not surprisingly, ACA proponents are dismissive of this latest legal challenge, saying the case has no merit and parties to the lawsuit have no standing. Then again, they said they same thing about the multi-state lawsuit challenging the individual mandate, that was ultimately resolved by the Supreme Court.

Standing

In its motion to dismiss to dismiss the Oklahoma suit, the US government argues, among other things, that the suit should be dismissed because the state lacks standing to argue that the employer penalties harm the state. If the court sides with the government and rules that Oklahoma lacks standing, the case will be tossed. The other case, *Halbig vs. Sebelius*, may not have that exact problem because it includes some plaintiffs who are business owners.

However, there are additional jurisdictional questions that could derail the case before it is considered on its merits. For instance, the government is likely to argue that employers also lack standing to challenge the employer penalties now that the mandate has been delayed to 2015. There’s also the question of whether the Anti Injunction Act might bar a pre-enforcement legal challenge to the employer mandate penalty.

It’s anyone’s guess as to how the lower courts might rule on these jurisdiction questions. But plaintiffs are encouraged by a recent 4th Circuit’s ruling in *Liberty vs. Lew* which dismissed the government’s arguments against standing, even though the 4th Circuit Court ruled against Liberty University’s challenge on its merits.

IRS Smoking Gun?

IRS issued key guidance in August of 2011 providing that premium tax credits can be funneled through all exchanges. After the Adler-Cannon legal argument emerged, House Republicans have repeatedly asked IRS to provide or cite the statutory provision that gives the IRS authority to authorize credits through federal exchanges.

House Republicans theorize that the IRS may have some internal legal analysis questioning whether the ACA authorizes subsidies to be provided through federal exchanges. The House Oversight and Government Reform Committee held a hearing July 31st on the IRS’s legal basis for expanding the ACA’s taxes and subsidies. Committee members complained that the IRS had not supplied the requested documents, but IRS said they turned everything they could given the ongoing legal proceedings.

We have no idea whether the IRS may be sitting on analysis that could harm the Administration’s position. Presumably a court could compel the IRS to hand over relevant documents more effectively than Congress, but we don’t say that with certainty. In any event, if the IRS does have internal analysis that casts doubt on whether the ACA
authorizes subsidies through federal exchanges, it could prove to be a smoking gun that might convince the courts that the Oklahoma case has merit.