No. 14-1158

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

DAVID KING, *et al.*,

Plaintiffs–Appellants,

v.

KATHLEEN SEBELIUS,
SECRETARY OF HEALTH AND HUMAN SERVICES, *et al.*,

Defendants–Appellees.

On Appeal from the United States District Court
for the Eastern District of Virginia (No. 3:13-CV-630 (JRS))

BRIEF OF JONATHAN H. ADLER AND MICHAEL F. CANNON AS *AMICI CURIAE* IN SUPPORT OF THE APPELLANTS

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INTEREST OF THE *AMICI CURIAE*[1]

Amici were among the first to consider the federal government's authority to extend subsidies for coverage purchased through federally established marketplaces. They have since, separately and together, published numerous articles, delivered lectures and testimony, and advised government officials on that issue and, in particular, on the regulation challenged here. They are the authors of the leading scholarly treatment of this issue, Jonathan H. Adler and Michael F. Cannon, Taxation Without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA, 23 Health Matrix J. L. Med. 119 (2013).

Jonathan H. Adler is the Johan Verheij Memorial Professor of Law and Director of the Center for Business Law and Regulation at the Case Western Reserve University School of Law in Cleveland, Ohio. Professor Adler teaches courses in constitutional and administrative law, among other subjects, and is the author of numerous articles on federal regulatory policy and legal issues relating to health care reform, including Cooperation, Commandeering or Crowding Out? Federal Intervention and State Choices in Health Care Policy, 20 Kan. J. L. & Pub. Pol'y 199 (2011).

[1] Counsel for the *amici curiae* certifies that no counsel for any party authored this brief in whole or in part and that no person or entity other than the *amici curiae* or their counsel made a monetary contribution intended to fund the brief's preparation or submission. All parties have consented to the filing of this brief.

Michael F. Cannon is the director of health policy studies at the Cato Institute, a non-partisan, non-profit educational foundation organized under section 501(c)(3) of the Internal Revenue Code, located in Washington, D.C., and dedicated to the principles of individual liberty, limited government, free markets, and peace. Cannon is a nationally recognized expert on health care reform. He holds masters degrees in economics (M.A.) and law and economics (J.M.).

SUMMARY OF ARGUMENT

The Patient Protection and Affordable Care Act of 2010 ("PPACA" or "Act") declares in Section 1311 (42 U.S.C. § 18031) that "Each State shall . . . establish" an "Exchange" to regulate health insurance within each state; directs the federal government in Section 1321 (42 U.S.C. § 18041) to establish Exchanges "within" states that "fail[]" to establish one; and in Section 1401 (26 U.S.C. § 36B) offers health insurance tax credits only to taxpayers who enroll in a qualified health plan "through an Exchange established by the State under Section 1311 of the Patient Protection and Affordable Care Act." The statutory language limiting tax credits to state-established Exchanges is clear, consistent, and unambiguous. The remainder of the statute and the PPACA's legislative history are fully consistent with the plain meaning of the tax-credit eligibility rules.

In 2012, the Internal Revenue Service issued a rule that, without any reasoned basis, offers premium-assistance tax credits through Exchanges

established by the federal government under Section 1321. The agency is presently issuing those tax credits in the 34 states that elected not to establish an Exchange. The IRS rule is contrary to the plain language of the PPACA and cannot be justified on other grounds. It exceeds the agency's authority and subverts congressional intent by altering the balance Congress struck between the Act's competing goals.

In order to induce state cooperation, Congress routinely conditions federal benefits to individuals—both via direct spending and the tax code—on their state carrying out congressional priorities. The legislative history shows the PPACA's authors and supporters repeatedly threatened to cut off health-insurance tax credits and subsidies in uncooperative states. The Act's supporters endorsed state-run Exchanges out of political necessity, and its authors clearly and unambiguously conditioned premium-assistance tax credits on states establishing Exchanges as one among a number of financial inducements for states to perform this task for the federal government.

Despite the clear, unambiguous language of the statute, the IRS claims its counter-textual rule reflects congressional intent. The IRS has not identified any statutory provisions that conflict with or create ambiguity about the PPACA's tax-credit eligibility rules. Nor has the agency identified even a single contemporaneous statement indicating that PPACA supporters expected the bill to

offer tax credits in federal Exchanges. The IRS simply rewrote the statute. The IRS's regulation is contrary to law and should be set aside.

ARGUMENT

I. The PPACA Authorizes Premium-Assistance Tax Credits Only in States that Establish Their Own Exchanges

The premium-assistance tax credit provisions of the PPACA clearly, consistently, and unambiguously authorize tax credits only in states that establish a health insurance "exchange" that complies with federal law. Section 1401 authorizes tax credits for the purchase of qualifying health insurance plans only "through an Exchange established by a State under section 1311 of the Patient Protection and Affordable Care Act." 26 U.S.C. § 36B(b)(2)(A), (b)(3)(B)(i), (b)(3)(C), (c)(2), (e); *see also* Adler & Cannon, *supra*, at 144–45. The IRS rule, by contrast, purports to authorize tax credits in Exchanges that are neither "established by the State" nor "established . . . under Section 1311."[2] This it cannot do. Because the language of the PPACA speaks directly to the question at issue, the IRS has no authority to provide tax credits in federal exchanges, nor is the IRS due deference in its interpretation of the Act.

[2] The Department of Health and Human Services recently announced it will likewise ignore the "through an Exchange" requirement and dispense tax credits to certain individuals who purchase coverage *outside of an Exchange*. *See* Centers for Medicare & Medicaid Services, Center for Consumer Info. & Ins. Oversight, CMS Bulletin to Marketplaces on Availability of Retroactive Advance Payments of the PTC and CSRs in 2014 Due to Exceptional Circumstances (February 27, 2014).

To avoid duplicative briefing, *amici* adopt the analysis of the statutory text contained in Section I.A of Appellants' Opening Brief ("Br."), with one exception that strengthens the case against the IRS rule. Appellants say the PPACA does not condition credits on "states' adoption of insurance reforms." Br. at 45. To the contrary, Section 1321 directs the Secretary to establish an Exchange—an action that cuts off tax credits to the state—if "the Secretary determines . . . that an electing State will not have any required Exchange operational . . . *or* has not taken the actions the Secretary determines necessary to implement the other requirements set forth in the standards under subsection (a); or the requirements set forth in subtitles A and C and the amendments made by such subtitles." 42 U.S.C. § 18041(c) (emphasis added). Section 1321 is thus the linchpin of a conscious effort by the PPACA's authors to use tax credits to *induce* states to implement various elements of the Act that Congress cannot constitutionally *compel* them to implement.

The district court nevertheless found that interpreting "established by the state" literally would lead to "anomalous results." J.A. 307. The district court relied principally on Section 1312, which provides that an individual who is qualified to purchase insurance through an Exchange must "reside[] in the State that established the Exchange." 42 U.S.C. § 18032(f)(1)(A)(ii). If that rule applied to federal Exchanges, then no one would be qualified to purchase coverage through

them. When read in context rather than isolation, however, this provision creates no anomalies. Early in Section 1311, Congress called upon states to establish Exchanges and offered financial support for this purpose. 42 U.S.C. §18031(b). In the remainder of Section 1311, as well as Sections 1312 and 1313, Congress then created rules for states that establish Exchanges. 42 U.S.C. §§ 18031, 18032, 18033. The very next section, Section 1321, explains what happens when that premise proves false because a state "fail[s]" to establish an Exchange. 42 U.S.C. §18041(c). Thus, when Section 1312 defines a "qualified individual" to be someone who "resides in the State that established the Exchange," it is because Congress was speaking *to the states* about the rules for state-established Exchanges. When Section 1321 then directs the Secretary to set standards for how federal Exchanges will follow the rules that the preceding three sections impose on state-established Exchanges, it merely obligates the Secretary to require that insurance purchasers reside in the state for which the Secretary established the Exchange.

The district court saw another "anomalous consequence," J.A. 310, in the provision of the PPACA requiring states to maintain their Medicaid programs' eligibility standards until the federal government determines "an Exchange established by the State under [Section 1311] is fully operational." 42 U.S.C. § 1396a(gg). If a state failed to establish an Exchange, it "would *never* be relieved of this maintenance of effort requirement," a "potential condition on state's power

over their Medicaid programs [that] could be unconstitutional." J.A. 309–10. Yet the fact that the plain meaning of the phrase "established by the State" could lead to an unconstitutional result is not "anomalous" in a statute where the Supreme Court has identified a nearly identical constitutional deficiency. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012) (*NFIB*). Indeed, that fact lends greater weight to the plain meaning of the text because it shows the plain meaning is perfectly consistent with Congress's purpose.

II. Congress Routinely Induces States To Carry Out Federal Priorities by Conditioning Benefits to Individuals on State Action

The district court's conclusion that it is "implausible," J.A. 306, that Congress conditioned tax credits on states establishing Exchanges is, moreover, detached from the history of our federalist system of government, and the PPACA's legislative history in particular. When the PPACA's authors crafted and Congress approved this condition on tax-credit eligibility, they utilized a well-established method of inducing state cooperation with federal priorities, one that the very members of Congress who approved the PPACA have employed repeatedly.

The federal government "may not compel the states to implement, by legislation or executive action, federal regulatory programs." *Printz v. United States*, 521 U.S. 898, 925 (1997); *see also New York v. United States*, 505 U.S. 144, 162 (1992); *NFIB*, 132 S. Ct. at 2602–3 (Roberts, C.J.). But Congress can, and

routinely does, provide various incentives to *encourage* states to implement federal programs or enact desired legislation. Such incentives include direct federal spending, as with the PPACA's expansion of the Medicaid program, and often include tax incentives for state residents.

The following examples demonstrate that conditioning federal health-insurance subsidies and, in particular, favorable tax treatment for state residents on state compliance with federal requirements is both commonplace and was a part of Congress's deliberations over the PPACA.

A. Congress Has Conditioned Health Insurance Subsidies to Individuals on States Implementing Federal Programs for Nearly Fifty Years

For 47 years, Congress has conditioned Medicaid grants to states on states enacting and operating Medicaid programs that meet federal specifications. 42 U.S.C. § 1396c; *NFIB*, 132 S. Ct. at 2601–02. Since 1997, the State Children's Health Insurance Program ("SCHIP"), has conditioned federal grants to states on each state's implementation of a health insurance program for children with low-to-moderate incomes. 42 U.S.C. §§ 1397aa–1397mm. Cong. Res. Serv., State Children's Health Insurance Program (CHIP): A Brief Overview (March 18, 2009). All 50 states and all U.S. territories participate in these programs.

B. The PPACA Is Not the First Time Congress Conditioned Health-Related Tax Benefits on States Enacting Certain Laws

The PPACA's primary author was Senate Finance Committee Chairman Max Baucus (D-MT). *See, e.g.,* Kate Pickert, Max Baucus, Obamacare Architect, Slams Healthcare.gov Rollout, TIME.com (November 6, 2013) (identifying Baucus as "a key architect of the law"). The PPACA's approach to Exchanges, and its language restricting tax credits to Exchanges "established by the State," originated in the bill Baucus drafted and shepherded through the Finance Committee. As early as 2002, Baucus embraced the idea of conditioning health-insurance tax credits on state action when he introduced a version of what would become the Trade Adjustment Assistance Reform Act.

The Trade Adjustment Assistance Reform Act of 2002 created "health coverage tax credits" (HCTCs) that pay 72.5 percent of qualified health insurance premiums for certain taxpayers. 26 U.S.C. § 35. The eligibility rules for HCTCs explicitly require that states must enact specified laws before certain of their residents may claim the HCTC. 26 U.S.C. § 35(e)(2); *see also* Cong. Res. Serv., Health Coverage Tax Credit Offered by the Trade Act of 2002 at ii (January 31, 2008), http://wlstorage.net/file/crs/RL32620.pdf ("The HCTC can be claimed for only 10 types of qualified health insurance specified in the statute, *7 of which require state action to become effective.*") (emphasis added).

The structure of the HCTC eligibility rules is nearly identical to the PPACA's tax-credit eligibility rules. *Id.* Congress made HCTCs available only during "coverage months," which would occur only when a taxpayer is enrolled in "qualified health insurance." 26 U.S.C. § 35(b). The rules defining these terms determine eligibility for tax credits. *See* Br. at 5–6.

Baucus' version of the bill imposed even more requirements on states than the final Trade Adjustment Assistance Reform Act did. Baucus' proposal would have required states to impose additional health insurance regulations, such as a minimum-loss ratio requirement, on those seven types of qualified coverage before purchasers could claim the HCTC. *See* Trade Adjustment Assistance Improvement Act of 2002, S. 2737, 107th Cong. (2d Sess. 2002).

Beginning in 2004, Congress allowed certain individuals to make tax-free contributions to health savings accounts (HSAs), but only if their state provided the regulatory environment required by federal law. 26 USC § 223(c)(2). As one prominent health-law expert explains:

> HSAs received federal tax subsidies only when the HSAs were coupled with high deductible health plans. *These tax subsidies were only available, therefore[,] in states where high deductible plans were permitted. This in turn meant that some states had to repeal or amend laws limiting plan deductibles.* Most states that had provisions limiting high deductible plans quickly fell into line, although a few did not, at least initially.

Timothy Jost, State-Run Programs Are Not A Viable Option For Creating A Public Plan (Jun. 16, 2009) (emphasis added).

III. PPACA Supporters Repeatedly Supported Legislation Threatening To Cut Off Federal Subsidies—Including Tax Credits—in Uncooperative States

The PPACA is the product of two bills, one approved by the Senate Finance Committee and the other approved by the Senate Health, Education, Labor & Pensions ("HELP") Committee. These bills shared the same basic structure. Each imposed similar regulations on private health insurance, and each offered subsidies to qualified individuals who obtain coverage through a health insurance Exchange. *See generally* America's Healthy Future Act of 2009, S. 1796, 111th Cong. (1st Sess. 2009); Affordable Health Choices Act, S. 1679, 111th Cong. (2009); Patient Protection and Affordable Care Act, Public Law 111-148, 111th Cong. (2010). In late 2009, senators and White House staff working in the office of Senate Majority Leader Harry Reid (D-NV) fashioned the PPACA as a compromise between the HELP and Finance bills. *See, e.g.,* David M. Herszenhorn & Robert Pear, White House Team Joins Talks on Health Care Bill, N.Y. Times, Oct. 15, 2009, at A24 (quoting Reid: "This is legislating at its best.").

A. PPACA Supporters Repeatedly Advocated Unlimited Start-Up Funds To Induce States To Establish Exchanges

Conditioning subsidies on states establishing Exchanges, as a means of encouraging states to establish them, enjoyed broad support among PPACA

advocates. The Finance bill, the HELP bill, and the PPACA each created incentives for states to establish Exchanges, including offering unlimited start-up funds to cooperative states. *See* America's Healthy Future Act of 2009, *supra*, at § 2237(c); Affordable Health Choices Act, *supra*, at § 3101(a); 42 U.S.C. § 18031(a)(2).

B. PPACA Supporters Conditioned Federal Grants on States Enacting Medical Malpractice Liability Reforms

Finance Committee Democrats, including Chairman Baucus, proposed new federal grants to states that adopt medical-malpractice liability reforms. S. Rep. No. 111-89. (During mark-up, Republican senators offered amendments that likewise would have conditioned new Medicaid grants on states enacting medical malpractice reforms. *Id*.) The proposal was adopted in the PPACA and approved by all 60 Democratic Senators. 42 U.S.C. § 280g-15.

The House-passed Affordable Health Choices for America Act created a similar program designed to encourage states to adopt medical malpractice liability reforms. That bill provided, "the Secretary shall make an incentive payment, in an amount determined by the Secretary, to each State that has an alternative medical liability law in compliance with this section." H.R. 3962, § 2531, 111th Cong. (1st Sess. 2009).

C. PPACA Supporters Repeatedly Threatened To Cut Off Health Insurance Subsidies To Induce State Cooperation

Conditioning health-insurance subsidies on state cooperation was a central feature of the PPACA. Indeed, the Supreme Court concluded the PPACA pushed this practice "pas[t] the point at which 'pressure turns into compulsion'" in the Act's Medicaid provisions. *NFIB*, 132 S. Ct. at 2604 (quoting *Steward Machine Co. v. Davis*, 301 U.S. 548, 590 (1937)). Both the PPACA and its antecedent bill reported by the Finance Committee conditioned all federal Medicaid grants on states expanding their Medicaid programs to cover all legal residents with incomes below 138 percent of the federal poverty level.[3] 42 U.S.C. § 1396a(a)(10)(A)(i)(VII) (as amended by PPACA § 2001(a)(1)(C)); America's Healthy Future Act of 2009, *supra*, at § 1601. A 7-2 majority of the Supreme Court likened this to putting "a gun to the head" of states. 132 S. Ct. at 2604.

The amount Congress originally intended to condition on states implementing the Medicaid expansion totaled roughly *12 times* the aggregate amount of tax credits and cost-sharing subsidies Congress conditioned on states establishing Exchanges. *Compare* Office of Management and Budget, Budget of the U.S. Government Fiscal Year 14, Historical Tables 163, *available at*

[3] In *NFIB*, the court allowed Congress to condition the PPACA's new Medicaid grants on states implementing the expansion. 132 S. Ct. at 2607–08. Though the original conditions were invalidated, there is no dispute about what Congress sought to accomplish or the meaning of the relevant statutory text.

http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/hist.pdf (federal Medicaid grants to states exceeded $250 billion annually, even before the PPACA) *with* Cong. Budget Office, The Budget and Economic Outlook: Fiscal Years 2013 to 2023, 16 (February 5, 2013) (projecting Exchange-related subsidies would total just $21 billion in 2014, and would remain less than one-quarter of total federal Medicaid grants through 2023).

Post-*NFIB*, Congress still conditions far more funding on state implementation of the "old" Medicaid program than on establishment of an Exchange. *See* 132 S. Ct. at 2607 (allowing states to decline the PPACA's Medicaid expansion without losing the "old" Medicaid grants). Nevertheless, the "new" conditional Medicaid-expansion grants still exceed the conditional Exchange subsidies. *See* Cong. Budget Office, Updated Estimates for the Insurance Coverage Provisions of the Affordable Care Act (March 13, 2012), at 11.

D. PPACA Supporters Proposed Small Business Tax Credits that Would Be Available Only in States that Established Exchanges and Implemented Other Insurance Reforms

In 2008, Sen. Richard Durbin (D-IL) introduced a bill that conditioned health-insurance tax credits for certain small businesses on states establishing Exchanges. The Small Business Health Options Program Act offered tax credits to "qualified small employers" that "purchas[e] health insurance coverage for [their] employees in a small group market *in a State which . . . maintains a State-wide*

purchasing pool that provides purchasers in the small group market a choice of health benefit plans, with comparative information provided concerning such plans and the premiums charged for such plans made available through the Internet." S. 2795, 110th Cong. (2nd Sess. 2008) (emphasis added). Sen. Durbin reintroduced the bill in 2009. S. 979, 111th Cong. (1st Sess. 2009) (identical language).

Co-sponsors of Sen. Durbin's bill included many senators who would later vote to approve the PPACA's tax credits, which were also authorized only in states that established Exchanges. Those senators include Durbin, Blanche L. Lincoln (D-AR), Amy Klobuchar (D-MN), Jeff Bingaman (D-NM), Herb Kohl (D-WI), Arlen Specter (R-PA, who later switched parties), Robert P. Casey, Jr. (D-PA), Joseph I. Lieberman (I-CT), Mark L. Pryor (D-AR), Roland Burris (D-IL), Jeanne Shaheen (D-NH), Kirsten Gillibrand (D-NY), and Mark Begich (D-AK). *Compare* S. 2795, 110th Cong. (2nd Sess. 2008) *and* S. 979, 111th Cong. (1st Sess. 2009) *with* U.S. Senate, Role Call Vote on H.R. 3590, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00396.

In a November 2008 "white paper" and through most of 2009, Finance Committee chairman Baucus proposed small-businesses tax credits modeled on S. 2795 and S. 979, and likewise conditioned on state action. *See* Senator Max Baucus, Call to Action: Health Reform 2009, Senate Finance Committee White

Paper (Nov. 12, 2008), at 20 ("Initially, the credit would be available to qualifying small businesses that operate in states with patient-friendly insurance rating rules."); *id*. at 32 n.10; Senator Max Baucus, Description of Policy Options – Expanding Health Care Coverage: Proposals to provide affordable coverage to all Americans, S. Comm. Fin. White Paper (May 14, 2009), at 14 ("small employers can purchase through the Health Insurance Exchange [where tax credits are available] once the federal rating rules are fully phased in by their state."); S. Comm. Fin., Framework for Comprehensive Health Reform 3 (Sept. 8, 2009) (proposing small-business tax credits available through "a SHOP exchange modeled after S. 979, the 'Small Business Health Options Program Act'"); S. Comm. Fin., America's Healthy Future Act, Chairman's Mark (Sept. 22, 2009) ("If a State has not yet adopted the reformed rating rules, qualifying small employers in the state would not be eligible to receive the credit").

The Finance Committee approved this proposal by conditioning small-business tax credits on states enacting specified health insurance regulations. America's Healthy Future Act of 2009, *supra*, at 182–83 (1st Sess. 2009) ("STATE FAILURE TO ADOPT INSURANCE RATING REFORMS.—*No credit shall be determined* under this section . . . *for any month of coverage before the first month the State establishing the exchange has in effect the insurance rating reforms*") (emphasis added); S. Rep. No. 111-89 ("If a State has not yet

adopted the reformed rating rules, qualifying small business employers in the State are not eligible to receive the credit").

E. The HELP Bill Cut Off Premium Credits in States that Failed To Establish Exchanges or To Implement Other Provisions of the Bill

Under the HELP bill, if a state established an Exchange ("Gateway"), residents could receive "credits" almost immediately. Affordable Health Choices Act, *supra*, § 3104(b)(1) (residents eligible for credits 60 days after Exchange certification). Yet if a state failed to establish an Exchange, or its Exchange fell out of compliance, or the state failed to enact specified insurance laws, the HELP bill withheld and even revoked credits from state residents. *Id*. at § 3104(b)–(c). If a state neither established an Exchange nor requested a federal Exchange, "the residents of such State *shall not be eligible for credits*" until four years after the date of enactment. *Id*. at § 3104(d) (emphasis added). The HELP bill *permanently* withheld credits in states that failed to implement the bill's employer mandate. *Id*. at § 3104(d); *see also* Adler & Cannon, *supra*, at 154-155. *See also* Timothy Jost, Health Insurance Exchanges in Health Care Reform Legal and Policy Issues, Washington and Lee Public Legal Studies Research Paper Series (2009) ("A state's

residents will only become eligible for federal premium subsidies . . . if the state provides health insurance for its state and local government employees.").[4]

Many HELP Committee members therefore supported both the HELP bill's and the PPACA's rules cutting off Exchange subsidies in uncooperative states. Those members include Sens. Jeff Bingaman (D-NM), Sherrod Brown (D-OH), Bob Casey (D-PA), Chris Dodd (D-CT), Kay Hagan (D-NC), Tom Harkin (D-IA), Jeff Merkley (D-OR), Barbara Mikulski (D-MD), Patty Murray (D-WA), Jack Reed (D-RI), Bernie Sanders (I-VT), and Sheldon Whitehouse (D-RI). *Compare* U.S. Senate, Roll Call Vote on H.R. 3590 *with* C-SPAN, Health and Education Committee Democratic Members, July 15, 2009, http://www.c-span.org/video/?287751-1/health-education-committee-democratic-members-.

F. The Finance Bill Clearly Cut Off Tax Credits in States that Failed To Establish Exchanges

The Finance bill offered tax credits to certain individuals only if they purchased a qualified health plan through a state-established Exchange. The bill specified that the "premium assistance amount" can only be calculated if there is "an Exchange established by the State," and that taxpayers are eligible for credits only during "coverage months," defined (by cross-reference) as months during which the taxpayer is enrolled in a qualified health plan purchased through "an

[4] HELP Committee Republicans offered an alternative bill that likewise would have conditioned new Medicaid payments to states on states establishing Exchanges. Patients' Choice Act, S. 1099, 111th Cong. (1st Sess. 2009).

exchange established by the State." America's Healthy Future Act of 2009, *supra*, § 1205.

G. Senator Reid Strengthened the Language Restricting Tax Credits to State-Established Exchanges Prior to Final Passage

When Senate leaders merged the Finance and HELP bills to create the PPACA in Sen. Reid's office, they *strengthened* the Finance language conditioning premium-assistance tax credits on states establishing an Exchange.

The Finance bill used a cross-reference to define "coverage months" as occurring only when taxpayers purchased insurance through an Exchange "established by the State." While Reid and his staff were overseeing the crafting of the PPACA, that already clear provision was augmented with language explicitly repeating, within the "coverage month" definition, that coverage months occur only when taxpayers enroll in a qualified health plan "through an Exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act." *Compare* America's Healthy Future Act of 2009, *supra*, § 1205, *with* PPACA § 1401, 26 U.S.C. § 36B(c)(2)(A)(i).

Note also that, while Senate leaders were strengthening the Finance language conditioning *Exchange* subsidies on state cooperation, they dropped the Finance language conditioning *small-business* tax credits on states enacting the required rating rules. This change had no practical effect because the PPACA still

conditioned Exchange subsidies on states implementing those and other insurance regulations.

IV. PPACA Supporters Likened Its Exchange Provisions to a Conditional Grant Program and Recognized Those Provisions Allow States To Block Exchange Subsidies

Many House members disapproved of the PPACA's approach to Exchanges *because* they recognized the bill would enable individual states to block Exchange-related benefits and thereby undermine the goal of expanded health insurance coverage.

In early 2010, all 11 Texas Democrats in the House of Representatives cosigned a letter to the President and House leadership warning against the PPACA's Exchange provisions. The Texas Democrats likened the Senate-passed PPACA's Exchange provisions to another conditional-grant program (SCHIP) and warned that uncooperative states would therefore be able to block its benefits:

> Not one Texas child has yet received any benefit from the Children's Health Insurance Program Reauthorization Act (CHIPRA) . . . since Texas declined to expand eligibility or adopt best practices for enrollment . . . . *The Senate approach [to Exchanges] would produce the same result—millions of people will be left no better off than before Congress acted*.

U.S. Rep. Doggett: Settling for Second-Rate Health Care Doesn't Serve Texans, My Harlingen News (Jan. 11, 2010) (emphasis added); *see also* Julie Rovner, House, Senate View Health Exchanges Differently, Nat'l Public Radio (Jan. 12, 2010) (the letter's authors "worry that because leaders in their state oppose the

health bill, *they won't bother to create an exchange, leaving uninsured state residents with no way to benefit from the new law*") (emphasis added).

Even though they recognized that the PPACA cuts off Exchange-related benefits in uncooperative states, all 11 Texas Democrats, as well as others whom they educated about that feature of the bill, nevertheless voted to enact the PPACA without any change in the language restricting tax credits to state-established Exchanges. *Compare* U.S. Rep. Doggett, *supra*, *with* U.S. House of Representatives, Final Vote Results for Role Call 165, Mar. 21, 2010, http://clerk.house.gov/evs/2010/roll165.xml.

V. Influential Legal Academics Urged Congress To Use Financial Inducements To Motivate States

Members of Congress were also counseled by health-law experts to use tax credits and subsidies for individuals as an inducement to get states to implement federal goals. One influential health-law scholar was Timothy Jost. *See* Press Release, W&L Law's Jost Invited to Health Care Bill Signing Ceremony (March 23, 2010) (stating that Jost attended singing with "secretaries and Congress people and various other leaders who had worked on the bill").

In 2009, when Congress was debating whether the states or the federal government should take a leading role in administering health insurance Exchanges, Prof. Jost explained that while Congress cannot compel states to operate Exchanges or enact other insurance reforms, it could encourage state

cooperation by "offering tax subsidies for insurance *only in states that complied with federal requirements* (as it has done with respect to tax subsidies for health savings accounts)." Timothy Jost, O'Neill Institute Legal Solutions in Health Reform, Health Insurance Exchanges: Legal Issues 7 (2009) (emphasis added).

When Chairman Baucus proposed encouraging states to establish their own "State-run public option" health plans, Baucus, Description of Policy Options, *supra*, Prof. Jost suggested, "Tax credits could be offered to subsidize the purchase of insurance, but *only in states that implemented a public program*." Jost, State-Run Programs, *supra* (emphasis added).

VI. The Legislative History of the PPACA Supports the Plain Meaning of the Statutory Text

The legislative history further shows the PPACA's authors had ample motivation to condition tax credits on states establishing Exchanges. While not all reform advocates wanted to rely upon state exchanges, Congress adopted this approach because it was the only way a bill could garner enough votes to pass the Senate. Such inducements would help to ensure state cooperation without running afoul of the constitutional prohibition on commandeering states. *See* Timothy Jost, O'Neill Institute Legal Solutions in Health Reform, Health Insurance Exchanges: Legal Issues 7.

A. Supporters of State-Run Exchanges Prevailed over Supporters of Federal Exchanges in the Senate

In November 2008, Chairman Baucus proposed a "nationwide insurance pool called the Health Insurance Exchange." *See* Baucus, Call to Action, *supra*. However, many observers, including state officials, favored a system of 50 state-run Exchanges rather than a single, nationwide Exchange operated by federal officials. Adler & Cannon, *supra*, at 148-49 n.107; NAIC Ltr. to Speaker Pelosi and Majority Leader Reid (Jan. 6, 2010) ("We urge . . . that health insurance Exchanges be established and administered at the state level with the flexibility to meet the needs of our local markets and consumers."). Key U.S. senators also favored state-run Exchanges. Patrick O'Connor & Carrie Brown, Nancy Pelosi's Uphill Health Bill Battle, Politico (Jan. 9, 2010) ("Two key moderates—Sen. Ben Nelson (D-Neb.) and Sen. Joe Lieberman (I-Conn.)—have favored the state-based exchanges over national exchanges."); *see also* Reed Abelson, Proposals Clash on States' Roles in Health Plans, N.Y. Times (Jan. 13, 2010) ("The state-federal divide between the House and Senate could be a difficult gap to bridge. One possible compromise would be to have a federal exchange set up alongside the state exchanges. Senator Ben Nelson, Democrat of Nebraska, is a former governor, state insurance commissioner and insurance executive who strongly favors the state approach. His support is considered critical to the passage of any health care

bill."); Carrie Brown, Nelson: National Exchange a Dealbreaker, Politico (Jan. 25, 2010).

By late 2009, the authors of both the Finance and the HELP Committee bills had abandoned the idea of a single, nationwide Exchange in favor of 50 state-run Exchanges, with the federal government operating Exchanges only in those states that declined to do so. *See* S. Comm. Fin., Framework for Comprehensive Health Reform (Sept. 8, 2009); S. Comm. Fin., America's Healthy Future Act, Chairman's Mark (Sept. 22, 2009); Affordable Health Choices Act, S. 1679, 111th Cong. (2009).

B. PPACA Supporters Cut Off Subsidies in Uncooperative States To Induce State Cooperation and Avoid Unconstitutional Commandeering

To avoid an unconstitutional commandeering of states, both the Finance and HELP Committees conditioned their health insurance subsidies to individual taxpayers on states establishing compliant Exchanges and implementing other elements of their bills' regulatory schemes. Those requirements were consistent with, and in addition to, other incentives each bill created to encourage state cooperation, including unlimited start-up funds for states establishing Exchanges and the Finance bill's imposition of a costly "maintenance of effort" requirement on state Medicaid programs that lifted only if states established a functional Exchange. *See* Br. at 37–38. As noted above, Senate leaders adopted and

strengthened the Finance bill's language restricting tax credits to state-established Exchanges in the PPACA.

C. Scott Brown's Election Rendered the PPACA the Only Bill that Could Pass Congress

House and Senate leaders had hoped to iron out differences between the two chambers' bills, but it was not to be. On January 19, 2010, Massachusetts voters elected Republican Scott Brown to the U.S. Senate. Brown had vowed to filibuster any compromise between the House bill and the PPACA, meaning that a compromise bill could no longer clear the 60-vote hurdle necessary to pass the Senate. Any hope of enacting anything but the PPACA disappeared. *See* Michael Cooper, G.O.P. Senate Victory Stuns Democrats, New York Times (January 19, 2010), http://www.nytimes.com/2010/01/20/us/politics/20election.html (noting once Brown takes office "the Democrats will no longer control the 60 votes in the Senate needed to overcome filibusters"). At that point, the *only* way Congress could have enacted a comprehensive health care bill was if the House enacted the Senate-passed PPACA. The choice was either the PPACA, which many members of Congress found quite unsatisfactory, or no health care bill at all.

D. Congress Approved the PPACA and the HCERA Without Any Changes to the Rules Limiting Tax Credits to State-Established Exchanges

House Democrats grudgingly agreed to enact the PPACA as-is, after receiving assurances that the Senate would approve the limited changes the House

planned to make to the PPACA bill through the reconciliation process, which Senate rules allowed Senate Democrats to do with just 51 votes, rather than the 60 required to overcome a filibuster. But the Senate's budget-reconciliation rules also limited the range and types of amendments that may be made. *See generally* Cong. Res. Serv., The Budget Reconciliation Process: The Senate's "Byrd Rule" (July 2, 2010).

The Health Care and Education Reconciliation Act, Pub. L. No. 111-152, 124 Stat. 1029, 1035 (2010) ("HCERA"), amended Section 36B seven times, but did not alter the rules restricting credits to state-established Exchanges. Adler & Cannon, *supra*, at 162-163.

E. The HCERA Shows Congress Did *Not* Intend To Authorize Tax Credits in Federal Exchanges

Congress included in the HCERA a provision directing the IRS to treat Exchanges established by U.S. territories as if they had been established by states. HCERA § 1204; PPACA § 1323 (42 U.S.C. § 18043), 124 Stat. at 1055–56 ("A territory that elects . . . to establish an Exchange in accordance with part II of this subtitle and establishes *such an Exchange* in accordance with such part *shall be treated as a State* for purposes of such part.") (emphasis added). Yet it included no language to create such equivalence between state-established Exchanges and federal Exchanges. This provision demonstrates that Section 1321's language directing the federal government to establish "such Exchange" does not create full

equivalence between federal and state-established Exchanges. Section 1323 specified that territories establishing "such an Exchange…*shall be treated as a state*" because Congress recognized the word "such" did *not* create the full equivalence the IRS claims.

The HCERA also imposed certain reporting requirements on both state-established and federal Exchanges. HCERA § 1004, 124 Stat. at 1035; PPACA § 1401 (adding § 36B(f) to Title 26). This provision identified Section 1311 Exchanges and Section 1321 Exchanges separately, reflecting Congress's understanding that the two types of Exchange are legally distinct. Were they equivalent, as the government now claims, there would have been no need to identify them separately. *See* Br. at 21, 30-31.

Even if Congress had wanted to use the HCERA to change Section 36B to authorize tax credits in federally established health insurance exchanges, Senate rules governing the consideration of reconciliation measures would likely have made it either procedurally or politically impossible. *See* Declaration of Douglas Holtz-Eakin, Brief of Jonathan Adler and Michael Cannon in *Halbig v. Sebelius*, No. 13-cv-623 (D.D.C. filed Nov. 18, 2013), Att. A, ¶¶14–16.

Some PPACA supporters may have *preferred* to authorize tax credits through both state-run and federal Exchanges, but like many proposals that could not command enough votes to pass the Senate, that was not an option. The choice

faced by supporters was between a bill many found inadequate and no bill at all. *See* Harold Pollack, 47 (Now 51) Health Policy Experts (Including Me) Say 'Sign the Senate bill,' *The New Republic* (Jan. 22, 2010), http://www.newrepublic.com/blog/the-treatment/47-health-policy-experts-including-me-say-sign-the-senate-bill (letter to House Speaker Nancy Pelosi from 51 signatories, including "long-standing advocates of progressive causes," acknowledging that the PPACA is "imperfect" but urging the House to "adopt the Senate bill, and the President must sign it").

F. If Congress Erred, It Was in Miscalculating States' Willingness To Implement the PPACA

The PPACA's tax-credit eligibility rules are clear and accurately reflect congressional intent. The IRS is trying to rewrite the statute because supporters failed to anticipate the widespread rejection by states of the role the law had assigned them.

As was widely reported at the time of the PPACA's enactment, PPACA proponents were confident that all states would establish Exchanges. Supporters never even contemplated the possibility that numerous states would refuse. *See* Remarks on Health Insurance Reform in Portland, Maine, 2010 Daily Comp. Pres. Doc. 220 (Apr. 1, 2010) (quoting President Barack Obama, ''by 2014, each state will set up what we're calling a health insurance exchange"); *see also* Dep'ts of Labor, Health & Human Servs, Educ., & Related Agencies Appropriations for

2011, Hearing Before a Subcommittee on Appropriations, House of Representatives, 111th Cong. 171 (Apr. 21, 2010) (statement of Kathleen Sebelius, Secretary, Department of Health & Human Services), http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg58233/pdf/CHRG-111hhrg58233.pdf (‘‘We have already had lots of positive discussions, and States are very eager to do this. And I think it will very much be a State-based program.’’); Br. at 6.

This mistaken assumption accounts for why the Congressional Budget Office scored the bill without considering whether tax credits would be limited to state-run Exchanges, why the agency scored the bill as if the federal government would not have to spend any money paying to implement federal Exchanges, and why the PPACA did not authorize funding for the creation of federal Exchanges. Adler & Cannon, *supra*, at 186-188; J. Lester Feder, HHS May Have to Get ‘Creative’ on Exchange, Politico (Aug. 16, 2011), http://www.politico.com/news/stories/0811/61513.html.

As this assumption began proving false, the IRS simply rewrote the law, without any serious effort to ascertain Congress’s intent. *See* H. Comm. on Oversight and Gov’t Reform, 113th Cong., Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law’s Taxes and Subsidies (Comm. Print 2014) (key IRS and Treasury staff describe to congressional

investigators how the agencies never seriously considered that "established by the State" might reflect congressional intent).

CONCLUSION

Many provisions of the PPACA have not worked out the way its supporters had hoped. *See, e.g.,* PPACA Implementation Failures: Answers from HHS Before the Energy and Commerce Comm., 113th Cong. (2013) (testimony of Sec. Kathleen Sebelius on the failures of Healthcare.gov). Some provisions of the Act have been struck down in Court, *NFIB*, 132 U.S. at 2600 (striking down mandatory Medicaid expansion). Other provisions have been repealed. *See, e.g.*, American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 642 (2012) (repealing the CLASS Act); *see generally* Cong. Res. Serv., Enacted Laws that Repeal or Amend Provisions of the Patient Protection and Affordable Care Act (ACA); Administrative Delays to ACA's Implementation, Memorandum to Hon. Tom Coburn (September 5, 2013), www.coburn.senate.gov/public/index.cfm?a=Files.Serve&File_id=b8e7a876-ee12-477f-8c62-a9dd9294f537 (finding Congress has repeatedly amended or repealed discrete provisions of the PPACA). As President Obama recently acknowledged, "Obviously, we didn't do a good enough job in terms of how we crafted the law." NBC News, Interview with President Obama (November 7, 2013), http://www.nbcnews.com/video/nbc-news/53492840.

If supporters believe the PPACA's premium-assistance tax credit eligibility rules are flawed, the way to repair the statute is through the legislative process. With this rule, the IRS has arrogated for itself the power to rewrite a federal statute, triggering federal appropriations and financial penalties beyond those authorized by the legislature. Such "administrative hubris" cannot stand. *See Brungart v. BellSouth Telecommunications, Inc.*, 231 F.3d 791, 797 (11th Cir. 2000).

If the IRS can offer tax credits to those who purchase health insurance in federally created Exchanges, there is nothing to stop it from offering them to other ineligible categories of individuals, such as households with income below 100 percent or above 400 percent of the poverty level, Medicare and VA enrollees, workers with employer-sponsored health insurance, undocumented residents, those who purchase coverage outside an Exchange, or purchasers of non-qualified health plans. As the IRS can identify no textual or other basis for its rule, it can provide no limit to the power it asserts here.

The decision to limit the availability of premium-assistance tax credits to the purchase of qualified health insurance plans in Exchanges established by states under Section 1311 may or may not have been a sound policy decision. That is not the question before this Court. The text of the PPACA clearly, consistently, and unambiguously provides premium-assistance tax credits for the purchase of qualified health insurance in Exchanges established by states under Section 1311,

and only in such Exchanges. The remainder of the PPACA's text and legislative history fully support the plain meaning of the text. As a result, the IRS lacks the authority to provide for tax credits in federally facilitated Exchanges.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5)(A) because it was prepared in Times New Roman, 14-point font. It complies with the type-volume limitations contained in Fed. R. App. P. 28.1(e)(2)(C), because it contains 6,867 words, excluding those parts of the brief excluded from the word count under Fed. R. App. P. 32(a)(7)(B)(iii).

Dated: March 10, 2014

/s/ Andrew M. Grossman
Andrew M. Grossman

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of March 2014, I electronically filed the original of the foregoing document with the clerk of this Court by using the CM/ECF system. I certify that the participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system. Pursuant to this Court's Rules, I will also file eight paper copies of the foregoing document, by overnight delivery, with the clerk of this Court.

Dated: March 10, 2014

/s/ Andrew M. Grossman
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