

Healthcare Solutions

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Manatt Analysis of the Supreme Court Ruling on the ACA

The long-awaited Supreme Court decision brings clarity to the future of health care reform and the implementation of the Affordable Care Act (ACA). The following represents Manatt's first take on the ruling and its implications. We will continue to develop a more detailed perspective in the days and weeks to come, and welcome the opportunity to work with you on how the ruling will impact your organization and those you serve.

The impact of the decision is dramatic, maintaining the pillars of health reform including the creation of insurance exchanges and premium tax subsidies, delivery system transformation and, with some limitations, the Medicaid expansion. Attention will now turn from whether and if reform will happen to how and at what pace, with virtually all health care stakeholders recalibrating their strategic plans to take into account the transformational initiatives being implemented through the ACA.

The timelines are short. All eyes will turn now to states as driving many of the key economic and operational details of ACA implementation. The focus will be on state decisions, including whether states will expand Medicaid - which, if implemented by all 50 states, extends health care coverage to 16 million Americans - and whether states will implement insurance exchanges on their own, in partnership with the federal government or rely on a Federally Facilitated Exchange.

As the implementation of the ACA proceeds, we expect more clarity in how the extensive expansion of coverage in the United States will interact and shape the way health care is paid for and delivered. While some have criticized the ACA for not doing enough to control health care costs, the reality is that the ACA has engendered the exploration of significant payment and delivery system restructuring.

Manatt's View

- The ruling will accelerate the already substantial efforts among states to implement the ACA.
- The decision removes constitutional obstacles to states implementing Exchanges for individuals and small businesses with market rules that facilitate stable risk pools and more affordable premiums.
- In addition to the decisions states already must make on implementing Exchanges, they must now decide on whether to accept federal funds to expand Medicaid.
- We believe that many states will accept the Medicaid expansion funding given that the federal government is paying all the costs in the short term and most of the costs in the long term, and that there will be major pressure to help low-income state residents.
- Providers already have much invested in ACA-related delivery system reform, and today's decision will reinforce these efforts. We predict that there will also be formidable advocates for the Medicaid expansion in order to limit exposure to the cost of covering the uninsured.
- Insurers will have an expanded customer base,

The Decision: A sharply divided Court ruled that the ACA requirement for individuals to have insurance or pay a tax penalty is constitutional. In a surprise move, the Court struck down a provision of the law that permits the Secretary of Health and Human Services (HHS) to condition federal Medicaid dollars on implementation of the ACA Medicaid expansion. This means that states can choose not to expand their Medicaid programs to cover all state residents under 133% of the federal poverty line (\$30,657 for a family of 4), without putting federal funding for their entire state Medicaid programs at risk.

Open Legal Questions: There are several open legal questions with regard to the implications of the Court's ruling for states that do not take advantage of the ACA Medicaid expansion, including states' obligations to maintain Medicaid and Child Health Insurance Program (CHIP) eligibility at 2010 levels (known as the "Maintenance of Effort" provision). Also at issue is whether individuals with incomes below 100% of the FPL

at least some of which will be subsidized, but will remain challenged to contain the cost of care absent provider collaborations.

living in states that don't take advantage of the ACA expansion option, will be eligible for federal premium tax credits in the Exchange. These and other questions that emerge in the coming days will require further research and guidance from the Administration.

Impact on the ACA: With the exception of the ruling that states will be able to forgo participation in the Medicaid expansion, the Court leaves intact the entire ACA, most notably:

- The requirement that individuals obtain coverage or subject themselves to a tax penalty;
- The law's insurance reforms including those that guarantee individuals' access to coverage regardless of pre-existing conditions and do not allow premiums to vary based on such conditions;
- Federal funding for the creation of health insurance exchanges in every state in the country;
- Substantial premium and cost sharing subsidies to those with incomes under 400% of the Federal Poverty Level to purchase insurance through Exchanges;
- Substantial payment and delivery reforms including authorization and funding for provider payment changes, Accountable Care Organizations, the Center for Medicare and Medicaid Innovation, the Patient Centered Outcome Research Institute and the Independent Payment Advisory Board; and,
- Premium rebates based on medical loss ratio, premium increase review, and other insurance reforms.

Implications for the ACA Medicaid Expansion: Because of the ruling, states confront a new decision: whether to expand their Medicaid programs to cover residents with incomes up to 133% of the FPL. The coverage expansion is likely to remain an attractive option for most states – offering the opportunity to provide health insurance for their lowest income residents and driving new revenue to their providers – almost entirely funded by the federal government. Experience shows that when states have access to federal matching dollars to provide coverage for vulnerable populations they do so. Today, approximately 60% of Medicaid dollars are spent on optional Medicaid populations and benefits, including pharmacy benefits – a costly optional service that all state Medicaid programs cover today. In terms of expansion populations, every state in the country has expanded its Medicaid programs above federal minimum levels, and in many states, substantially.

States may be even more likely to take up the ACA Medicaid expansion given the ability to access federal funding for the full cost for expanded coverage for the first 3 years, leveling off at 90 cents on the dollar in 2020 and beyond. It may be that some states will not opt to take up the expansion, focusing on the 10% for which they will be liable in 2020 – and the Court's ruling now allows them that choice.

A significant issue for states that opt out of the ACA Medicaid expansion relates to availability of federal premium tax credits for residents under 100% of FPL. In states that choose not to implement the expansion, it appears that only a limited number of individuals who would otherwise have been eligible for the ACA Medicaid expansion will be able to access the law's premium tax credits to purchase health insurance through an Exchange. This is because the ACA appears only to extend tax credits to individuals with incomes between 100% and 400% of the FPL, under the assumption that individuals below this level would be eligible for Medicaid. Notably, a provision in the law intended to provide access to tax credits for legal immigrants who are ineligible for Medicaid because they have been in the country for less than five years may afford access to tax credits for legal immigrants with incomes below 100% FPL, while citizens at the same income level are ineligible for tax credits.

Implications for Exchanges: To date, 49 states and the District of Columbia have received more than \$2 billion in start-up funds, and many are planning for the next round of grants. The 20 states that have a shot at certifying their state-based Exchanges by the end of the year are likely to intensify their efforts. Among states currently gridlocked over Exchange

legislation, some will remain in a holding pattern until the election, but more will hedge their bets by accelerating their agency level work to maintain control over ACA implementation at the state level. One immediate deadline looming is the November 16th date for states to submit their Exchange implementation plans for Secretary certification.

In many respects, the ruling is the best case outcome for insurance carriers. They maintain access to market expansion driven by Exchanges and premium tax credit subsidies plus the individual mandate that they regard as integral to stable risk pools. Carriers in the Medicaid managed care marketplace are likely to exert pressure on states to take advantage of the Medicaid expansion opportunity in the ACA. Insurers can be expected to intensify efforts to drive delivery system reform, including collaborating with stakeholders to reduce the cost of health care delivery.

Implications for ACA Delivery System Reforms: Delivery system reforms spurred and funded by the ACA will continue and intensify. Providers will increase their investment in implementation of ACA initiatives including the Medicare Shared Savings Program, dual eligible demonstrations, Pioneer Accountable Care Organizations, and numerous primary care initiatives.

Providers will likely advocate for states to access generous federal funding to expand Medicaid coverage to uninsured patients. Under the ACA, Medicaid funding currently available to help hospital providers cover some costs of the uninsured is dramatically reduced, under the assumption that there will be fewer uninsured, and therefore lower costs for uncompensated care. States that opt not to expand their Medicaid programs will find that their providers will be left in a difficult spot – fewer dollars to cover the cost of care for the uninsured, but continued demand for uncompensated care from the states' poorest residents. In a time of increasing cost pressures on providers, this will be an untenable situation in most states.

What's Ahead: The political repercussions of the decision will dominate the news but, very quickly, the practical implications will once again come to the forefront.

The Administration will need to craft guidance for states and stakeholders to address the issues created by the Court's ruling on the ACA Medicaid expansion. States committed to ACA implementation will continue to partner with the Administration to develop and implement solutions. Even the many states that do not support the ACA are likely to begin or accelerate implementation of the law, perhaps behind the scenes, at least until after the election.

We do not foresee any Congressional action to alter the ACA this year. The elections will be critical, but regardless of who wins the presidency and which party controls the House and Senate, we believe that the Supreme Court has given the ACA a major shot in the arm and by January 2013, the momentum behind the law will make repeal more difficult.

Frequently Asked Questions About the Supreme Court Decision:

1. What is the significance of the Supreme Court's upholding the mandate?

The decision eliminates the major legal obstacle to implementation of the ACA and puts the states in the driver's seat to accelerate their implementation efforts in standing up state exchanges and modernizing their Medicaid systems. The political debate over the law will continue through the election, but look for the 49 states that already have federal dollars to implement the law to focus on getting ready for the 2014 coverage expansion.

2. What did the Court's ruling say about the Medicaid expansion?

The Court struck down a provision of the law that permits the Secretary of Health and Human Services (HHS) to condition federal Medicaid dollars on implementation of the ACA Medicaid expansion. This means that states can choose not to expand their Medicaid programs to cover all state residents under 133% of the federal poverty line (\$30,657 for a family of 4), without putting federal funding for their entire state Medicaid programs at risk.

There are several open legal questions with regard to the implications of the Court's ruling for states that do not take advantage of the ACA Medicaid expansion, including states' obligations to maintain Medicaid and Child Health Insurance Program (CHIP) eligibility at 2010 levels (known as the "Maintenance of Effort" provision). Also at issue is whether individuals with incomes below 100% of FPL living in states that don't take advantage of the ACA expansion

option, will be eligible for federal premium tax credits in the Exchange. These and other questions that emerge in the coming days will require further research and guidance from the Administration.

3. Is this the final legal word on the Affordable Care Act?

For the time being, the Supreme Court has addressed all of the major constitutional issues raised by challengers. However, it is likely that opponents of the law will bring further litigation challenging specific issues where they believe the implementation of the ACA is inconsistent with the statute itself. While such challenges face high legal hurdles, they do represent viable ways for the courts to further involve themselves in defining the ACA.

4. Why are the reactions of key stakeholders more muted than those of political leaders?

Key stakeholders, especially the most powerful ones, tend to keep a low profile when partisan rhetoric is dominating the media. But there is a larger dynamic as well: most major stakeholders in the health care sector – insurers, providers, and employers – have a lot invested in the ACA and most stand to gain if the law moves forward. As partisan rhetoric flows freely on both sides, look for the major stakeholders to continue working quietly on implementation. Watch for the insurers to defend the law's \$930 billion in tax credits and Medicaid expansion dollars and to support continued development of state-based exchanges to transform the marketplace in 2014. Look for hospitals concerned about bad debt and large employers concerned about cost shifts to continue moving forward as well. Advocates for repeal have never had much stakeholder support, and that is not likely to change now.

5. What does the decision mean for the general public?

Public opinion is highly polarized over the ACA as a whole, but polls consistently find high levels of support for guaranteeing access to coverage for everyone regardless of preexisting conditions. This is the true heart of the ACA. The battle for hearts and minds will continue into the fall, but watch for consumer advocacy groups and other supporters of the law to use this opportunity to ratchet up their support for the mandate as necessary to make coverage affordable for everyone. Also watch for more focus on the true beneficiaries of this law: the 32 million uninsured who stand to gain coverage, as well as the millions of Americans who already are benefiting from better coverage for drugs and preventive services.

6. What will the states do?

Initial reactions from state political leaders are likely to mirror the ideological polarization coming from national leaders. But watch what the states do more than what they say. To date, 49 states and the District of Columbia have received more than \$2 billion in start-up funds, and many are planning for the next round of grants. California has indicated that it will apply for another \$188 million, and look for the 20 states that have a shot at certifying their state-based exchanges by the end of the year to intensify their efforts. Among states currently gridlocked over exchange legislation, some will remain in a holding pattern until the election, but more will hedge their bets by accelerating their agency level work to maintain control over ACA implementation at the state level.

Because of the ruling, states confront a new decision: whether to expand their Medicaid programs to cover residents with incomes up to 133% of the FPL. The coverage expansion is likely to remain an attractive option for most states – offering the opportunity to provide health insurance coverage for their lowest-income residents and driving new revenue to their providers – funded almost entirely with federal dollars. History shows that when states have access to federal matching dollars to provide coverage for vulnerable populations they do so. States may be even more likely to take up the ACA Medicaid expansion given the ability to access federal funding for the full cost for expanded coverage for the first three years, leveling off at 90 cents on the dollar in 2020 and beyond. It may be that some states will opt not to take up the expansion, focusing on the 10% for which they will be liable in 2020 – and the Court's ruling now allows them that choice.

7. Is there still time for states to achieve certification of a state-based exchange this year?

The Supreme Court decision will cause all states to pay more attention to the requirement for the Secretary of HHS to certify state exchanges by January 1, 2013, and to stand up a federally-facilitated exchange in those states that have not achieved state certification. States

that have been lagging until now will have a difficult time achieving full certification on that timeline. However, the HHS regulations give states some flexibility, with conditional certification and partnership. Conditional certification allows states that are not fully ready in late 2012 to buy some more time to achieve certification in 2013. Partnership allows states that may not be ready until 2014 or later, plus states that simply do not want to take on all exchange functions, to divide up functions with the federally-facilitated exchange. Given the tight timelines and the political uncertainty surrounding the ACA, it is possible that a majority of states may choose partnerships this year.

8. What does it mean for a state to be in a “partnership exchange”?

States have a continuum of options in operating their exchanges in a way that meets their unique needs, including partnering with the federal government to share responsibility in operating exchanges. States can choose the partnership approach as a permanent solution or use the partnership as a way station to a state-based exchange. The most common form of partnership will have the federally-facilitated exchange handle eligibility and enrollment (with the state having the option to make the final call on Medicaid eligibility) and the state handle certification and oversight of insurers, agents, and Navigators. The National Association of Insurance Commissioners (NAIC) has engaged virtually every state insurance department in a project to upgrade NAIC technology to make it relatively easy for states to continue their traditional role of overseeing insurers. Insurers are strongly supportive of continuing to work with state regulators rather than directly with a federally-facilitated exchange. States can stay in partnerships long term, but many will want to continue using federal grants (available through 2015) to transition to a state-based exchange.

9. Will the federally-facilitated exchange be ready to support state partnerships and provide a back-up exchange in states that choose not to go forward?

No one can know for sure more than a year out whether the federally-facilitated exchange will be fully ready for the first open enrollment period in October 2013. But we do know that HHS has contracted with experienced firms to meet this timeline and has been providing regular progress updates. At the most recent state conference, attended by more than 40 states, HHS leaders encouraged all states, including those most confident of achieving certification as a state-based exchange this year, to hedge their bets by also filing a partnership application in case their state exchange was not fully ready in time. HHS recently stated that the federally-facilitated exchange will be an “open marketplace” where all insurers that meet minimum standards can compete.

10. Do the federal and state governments have the capacity to extend coverage to more than 30 million people in the next few years?

While the challenge of providing timely access to care looms large, the ACA has spurred both expansion and important reforms of the health care delivery system. For example, Medicaid rates for primary care services will increase to Medicare levels in 2013. Through 2014, the increase will be funded entirely with federal dollars. Over \$2 billion has been awarded to community health centers throughout the country to enable them to expand their services to millions more patients. And, the Center for Medicare and Medicaid Innovations has made available nearly \$3 billion to states, hospitals, physicians, and clinics to enable them to reform their delivery models to improve the quality and efficiency of the care they deliver. Finally, both qualified health plans offered in the Exchange as well as Medicaid and CHIP managed care plans must meet network adequacy requirements. Ensuring that all Americans have timely access to quality, cost-effective care cannot be accomplished overnight, but there is no doubt that the work is well under way.

11. Won't the election be more important than this decision in the long run?

The elections will be critical, but regardless of who wins the Presidency and which party controls the House and Senate, the Supreme Court has given the ACA a major shot in the arm, and by January 2013, the momentum behind the law will make repeal extremely difficult. The coverage expansion will still be controversial and subject to mid-course corrections, but other aspects of the law, such as payment reform, clinical integration, and other delivery system innovations, will be baked into the health care landscape. A second Obama term will solidify the coverage expansion. A Romney Administration, especially if there is a Republican majority in the Senate, will have the chance to significantly redirect the law's implementation. But states that have invested significantly in building exchanges and

modernizing their Medicaid systems will press a Romney Administration for the same federal support that he received as Governor of Massachusetts.