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It's time for White House to start sweating over legal challenge to Obamacare subsidies

By Philip Klein

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As the U.S. Supreme Court weighed the constitutionality of a contraception coverage mandate Tuesday morning, a federal appeals court heard a separate legal challenge that could have much more sweeping implications for the future of President Obama's health care law.

And if the oral arguments before the U.S. Court of Appeals for the D.C. Circuit are any indication, it's time for the White House to start sweating over a lawsuit that up until now has flown relatively below the radar.

At issue in the case are the subsidies that the federal government provides for individuals purchasing insurance through Obamacare. Though the text of the law says the subsidies were to go to individuals obtaining insurance through an "exchange established by the state," a rule released by the Internal Revenue Service subsequently concluded that subsidies would also apply to exchanges set up on behalf of states by the federal government.

The case before the appeals court, *Halbig v. Sebelius*, is one of several challenging the IRS rule.

Were the case to succeed, it would mean that dozens of state governments opposed to Obamacare could significantly narrow its scope by refusing set up exchanges, thus preventing residents from claiming subsidies. In those states, employers wouldn't be penalized for failing to offer qualifying insurance (which is triggered by workers seeking federal subsidies), meaning that anti-Obamacare states could become more attractive to businesses trying to get around the employer mandate. It would also increase pressure on Congress to undo the individual mandate.

On the flip side, such a ruling would also place pressure on anti-Obamacare governors, who would be forced to decide whether to stand firm in opposition to Obamacare or to set up their own exchanges so residents can apply for subsidies.

The Obama administration has argued — and the lower court affirmed — that viewed in its entirety and taking into account the legislative history, Congress obviously intended for subsidies to go to individuals purchasing insurance on all exchanges regardless of which entities were running them.

But in oral arguments Tuesday, that wasn't necessarily obvious to a majority of the three-judge panel, which seemed divided on the question.

On the one end, Judge Harry Edwards, a nominee of President Carter, dismissed the challenge as "preposterous," describing it as a desperate attempt to gut the law. On the other end, Judge Raymond Randolph, a President George H.W. Bush nominee, called it "a leap" for the Obama administration to argue that when Congress used the language "established by the state" legislators really meant the federal government.

That left Judge Thomas Griffith, nominated by President George W. Bush, sitting both physically and metaphorically in the middle. Griffith asked skeptical questions of both sides, emphasizing that the text of the law clearly referred to subsidies going to an "exchange established by the state," but also weighing the broader legislative history.

Under the design of the law, states were given the option of setting up their own health insurance exchanges. If states chose not to, then Secretary of Health and Human Services Kathleen Sebelius could set up exchanges on their behalf. In total, exchanges in 36 states were created at least in part through the federal government.

Michael Carvin, a veteran of the 2012 health care case that went to the Supreme Court, in representing the challengers, argued that Congress intentionally limited subsidies to state-based exchanges as an incentive for states to set up their own exchanges. In other words, governors who didn't set up exchanges would be facing pressure by residents who wouldn't have access to hundreds of billions of dollars in federal subsidies.

Edwards ripped into Carvin, explaining that he had gone through the legislative history thoroughly and hadn't found evidence that Congress intended for subsidies to be limited to states that created their own exchanges. He said the idea that limiting the subsidies was meant as an incentive "seems preposterous," adding, "no one understood what you're arguing now at the time the bill was being passed."

He said that Carvin was running with a strange argument in an effort to "kill" the health care law. "That's what this is about, gutting the act."

The judge prodded Carvin to explain why Congress saw it as such an advantage to have states rather than the federal government manage the exchanges. "Why does it matter who establishes the exchanges?" he asked. "Your argument makes no sense."

He said, "Who cares?"

At that point, Randolph jumped in and said, "Ben Nelson."

Carvin agreed, arguing that Nelson, the former senator from Nebraska, was withholding support for Obamacare, in part, because he wanted exchanges to be state-based rather than federally-run. To get the law across the finish line, the Senate voted to make exchanges state-based, with the powerful inducement of generous subsidies.

When Stuart Delery of the Department of Justice appeared to make the case for the Obama administration, arguing that Carvin was taking one isolated phrase out of context, Randolph pounced. The judge said that by his count, the phrase "established by the state" appeared no less than seven times in the relevant section. "It's not an isolated reference," he said.

He was also dismissive of the argument that other parts of the law could be melded with the "established by the state" text to explain that the clear meaning was that subsidies should be available to individuals in all exchanges.

"What we have here is language that doesn't seem malleable in any way, shape, or form," Randolph said.

He also argued that Obamacare has involved a series of bad predictions by Congress. "The launch was an unmitigated disaster," Randolph said, and despite the predictions, "the costs have been sky high." He asked, "What if Congress acted on the assumption that dangling this carrot" in the form of subsidies would induce states to establish an exchange?

He pointed out that Congress assumed more states would set up their own exchanges, as evidenced by the relatively small amount of money allocated to the federal government to set up exchanges. When the IRS issued its ruling that subsidies would be available regardless of who established the exchange, it changed the calculus and there was no longer much of an incentive for states to do so.

When questioning Carvin, Griffith asked if they could look at the text alone, rather than the structure and legislative history. He asked whether there was any evidence at the time that the issue of limiting subsidies to the states as an inducement was on the mind of legislators. Or, he asked, did it merely surface after the fact once libertarian health care scholar Michael Cannon of the Cato Institute raised the issue along with Case Western University law professor Jonathan Adler.

After Carvin noted that Timothy Jost, a Washington and Lee University law professor who was influential in the health care debate advocated this strategy, Griffith shot back: "Which state does Jost represent?"

However, Griffith was critical of the case being made by the Obama administration. Several times, he pointed out that the key part of the phrase "established by the state" seemed to be who was establishing the exchange, a distinction Delery was trying to portray as arbitrary for the purpose of subsidies.

"It wasn't established by a state" if HHS set it up, he argued. He said that he thought the government had a "special burden" to demonstrate the legislative history is on the administration's side given that the plain language of the law contradicted them.

He also asked whether, if Congress didn't legislate something clearly, it was really the court's job to fix the statute.

When Delery argued that the clear purpose of the act was to expand insurance coverage by making it more affordable, Griffith countered that political compromise (in this case, encouraging states to start their own exchanges) may complicate lawmakers' original purpose.

As always, it's hard to predict judicial outcomes based on oral arguments, a lesson that was made abundantly clear when many observers predicted that the Supreme Court would strike down the individual mandate only to see it upheld. But it's fair to say that based on the oral arguments, two of the three judges seemed at least open to the idea of striking down the IRS rule, which would almost certainly send the issue to the Supreme Court.

Even this possibility should be enough to make Obama administration officials a bit nervous, given how dramatically an adverse ruling could effect their implementation strategy for the health care law.