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CONFIDENTIAL

SUMMARY OF CONFERENCE CALL ON JUNE 7, 2005

Potential Constitutional Challenge to the Part D Clawback Provision

The firm was recently invited to deliver a presentation via conference call to state representatives describing possible grounds for challenging the constitutionality of the “clawback” provision of the Medicare Part D drug benefit. We were asked by participants on the call to summarize our analysis, which is the purpose of this document. We wish to emphasize that this is not intended, and should not be viewed as, a comprehensive legal analysis, but an outline of arguments that would require further development through additional legal research in the event litigation were to be pursued. We believe the success of such a challenge would hinge primarily upon two fundamental propositions: 1) the clawback is not accurately characterized as an element in the determination of the amount of federal Medicaid payments due the states under Title XIX of the Social Security Act (Medicaid); and 2) because the clawback is not an offset against federal payment in the calculation of federal financial participation in Medicaid, it constitutes a tax upon the states in violation of the Tenth Amendment.

The Tenth Amendment reserves to the states all “powers not delegated to the United States by the Constitution, nor prohibited by it to the States.” U.S. Const. Amend. X. The enumerated powers of Congress expressly include the power to “lay and collect taxes...to pay the debts and provide for the...general welfare of the United States.” U.S. Const. Art. I, Section 8. However, the Supreme Court has interpreted Congress’ Article I powers as authorities to act upon the American people, not upon sovereign state governments. See e.g., New York v. United States, 505 U.S. 144, 162, 166 (1992); Printz v. United States, 521 U.S. 898, 918-22 (1997). Thus the federal government does not have Constitutional authority to tax states in their capacities as sovereign entities.¹ The critical question for analysis, therefore, is whether the clawback is a tax on the states or a simple mechanism for lowering states’ Medicaid payments from the federal government to adjust for an anticipated reduction of states’ Medicaid costs. We believe there is a strong legal basis to argue that the clawback represents a tax – not a new aspect

¹ There are, however, circumstances in which a state is acting as the functional equivalent of a private business entity, and may be taxed in that capacity.

of calculating Medicaid federal financial participation – and is accordingly unconstitutional and invalid.

The Clawback Is Not a Condition of Participation in the Medicaid Program or a Determinant of Federal Financial Participation

The recently enacted provision of law at Section 1935 of the Social Security Act requires states to subsidize the new drug benefit offered under Medicare Part D. 42 U.S.C. 1396u-5(c). Section 1935 requires that all states “shall provide for payment” to the Secretary of HHS for a portion of the costs of providing drugs under Part D of the Medicare program to individuals who are eligible for both Medicare and Medicaid. *Id.* These payments, known as the “clawback,” are deposited in the federal Medicare Prescription Drug Account. *Id.* at § 1396u-5(c)(1)(B). If a state fails to comply by paying the clawback, the federal government will charge interest on the amount owed and will also offset the unpaid amounts against federal Medicaid payments to that state. *Id.* at § 1396u-5(c)(1)(C).

If this provision amended Title XIX of the Act by establishing an additional condition of states’ participation in the Medicaid program, or an additional element in the methodology for determining the amount of federal payments due states under the Medicaid program, there would be little basis for Constitutional objection, as the clawback would in that case probably fall within the scope of Congress’ spending power. However, while Section 1935 was enacted as an amendment to the Medicaid statute, the plain language and structure of the amendment demonstrate that the clawback is not an element of determining the federal government’s liability for federal Medicaid payments. This is clear from the juxtaposition of different subsections of Section 1935 itself. Subsection (a), in the first instance, requires states to provide HHS with various types of information relevant to the Part D prescription drug benefit. Subsection (a) is clear that these information sharing requirements are conditions of participation in the Medicaid program: “As a condition of its State plan under this title . . . and receipt of any Federal [Medicaid] financial assistance . . . a State shall do the following”: 42 U.S.C. § 1396u-5(a). The provision then lays out information that states must provide to the federal government.

The clawback provision, by contrast, is located in subsection (c) of Section 1935 and contains very different language than that employed in subsection (a) of the same section. If Congress had intended the clawback to be a condition for receipt of Medicaid funds, Congress could easily, and presumably would, have included in subsection (c) a statement similar to that in subsection (a), explicitly stating that receipt of federal financial participation (FFP) in Medicaid costs is contingent on complying with the clawback. Moreover, if the clawback was intended as a factor in the determination of federal Medicaid payments to states, the structure of the Medicaid statute indicates that it would have been enacted as an amendment to Section 1903 of the Act (establishing the amount and methodologies for determining the amount of payment to states). The clawback provision of Section 1935, however, neither amends, contradicts, nor refers to the “payment to states” provisions in Section 1903. It merely demands payment from the states to fund a newly established Medicare benefit and establishes an expedient means of collecting the federally imposed tax if a state refuses to pay.

The Clawback Unconstitutionally Violates State Sovereignty

Because the clawback is neither a condition of participation in the Medicaid program nor a deduction from federal Medicaid payment obligations, the clawback amounts to a federal tax upon the states. The clawback is unconstitutional because the Constitution does not grant to Congress the power to tax states, and for that reason, Congress has violated state sovereignty guaranteed by the Tenth Amendment to the Constitution.

The incompatibility of the clawback with Constitutional restraints on federal power is also apparent from another perspective. The Supreme Court has identified an “anti-commandeering principle” that is inherent in the Tenth Amendment. This principle prohibits Congress from commandeering the sovereign functions of state governments. The Tenth Amendment permits Congress to preempt inconsistent state laws by enacting legislation directly affecting the citizenry, and Congress may also use incentives to encourage states to carry out federal programs. New York, 505 U.S. at 167, 188. Congress may not, however, “commandeer” state governments by forcing a state legislature to enact federal requirements, New York, 505 U.S. at 188, or by conscripting members of state a executive branch to enforce federal programs, Printz, 521 U.S. at 935. We would argue that the clawback commandeers the state budgetary process and state legislatures, forcing them to appropriate money from state funds to support a wholly federal medical insurance program.²

The anti-commandeering principle is rooted in the structure of the Constitution, which, as mentioned above, limits Congress to enumerated powers and authorizes Congress to act upon the American people, not upon sovereign state governments. New York, 505 U.S. at 162, 166 (1992); Printz, 521 U.S. at 918-22 (1997). This structure ensures that both states and Congress remain accountable to the people because the lines of responsibility are clear; Congress is responsible for its federal regulatory programs, and the states are responsible for theirs. New York, 505 U.S. at 168; Printz, 521 U.S. at 918-22. The clawback obliterates the lines of responsibility for state and federal actions and thereby violates the constitutional scheme: “By forcing state governments to absorb the financial burden of implementing a federal regulatory program, Members of Congress can take credit for ‘solving’ problems without having to ask their constituents to pay for the solutions with higher federal taxes.” Printz, 521 U.S. at 930. The Supreme Court has clearly indicated that such conduct violates constitutional limits on federal authority; yet this is precisely what Congress has sought to achieve through the clawback.

In summary, the clawback has shifted part of the cost of the Medicare Part D drug benefit to the states. A strong argument can be made that in enacting the clawback, Congress has legislated beyond the powers granted to it in the United States Constitution, and has violated the Tenth Amendment in two related but conceptually distinct ways: (1) by commandeering sovereign state functions (state legislative functions in the budgetary process), and (2) by taxing the states in their capacities as sovereign governmental entities. In our view, therefore, litigation challenging the clawback as unconstitutional would have a firm foundation and a reasonable chance of success. It is important to note that elimination of clawback would not prevent the rest

² Although the anti-commandeering principle is established in Supreme Court precedent, some federal Circuits have been more hospitable to that doctrine and to Tenth Amendment challenges in general, than others.

of the Part D Medicare program from moving forward. It would only shift the cost of Part D entirely to the federal government that is, in fact, wholly responsible for initiating and implementing that program.

Any individual who has further inquiries regarding the above or would like to discuss these matters further with one of the firm's attorneys should call or leave a message for Ron Connelly on 202-466-6550.