IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
WICHITA FALLS DIVISION

TEXAS, KANSAS, LOUISIANA, INDIANA, WISCONSIN, and NEBRASKA, *Plaintiffs,* v. UNITED STATES OF AMERICA, UNITED STATES DEPARTMENT OF HEALTH AND HUMAN SERVICES, ALEX AZAR, in his Official Capacity as SECRETARY OF HEALTH AND HUMAN SERVICES, UNITED STATES INTERNAL REVENUE SERVICE, AND DAVID J. KAUTTER, in his Official Capacity as ACTING COMMISSIONER OF INTERNAL REVENUE, *Defendants.*	§	Civil Action No. 7:15-CV-00151-O

REPLY BRIEF IN SUPPORT OF PLAINTIFFS' MOTIONS FOR LEAVE TO FILE A SECOND AMENDED COMPLAINT AND FOR EXPEDITED CONSIDERATION OF THE MOTION FOR LEAVE TO AMEND

IRS issued final bills for the 2018 Health Insurance Providers Fee ("HIPF") on August 31, 2018. Payments are due a mere 31 days later, on October 1, 2018. Only within this small window of time do Plaintiffs have an opportunity to prevent the threat of irreparable harm regarding the 2018 HIPF. And for any injunctive relief to be effective, Plaintiffs respectfully submit that it must be ordered no later than September 24, 2018 so that the parties have at least four business days to notify third parties of any ruling and effectively implement such a ruling.

Therefore, Plaintiffs respectfully ask this Court to grant their Motion for Leave to File a Second Amend Complaint ("Motion for Leave"), on an expedited basis, so that they may challenge the legality of the 2018 HIPF by filing a motion for temporary restraining order and preliminary injunction and seek a ruling by month's end.

Plaintiffs also respectfully ask for the quickest possible ruling, given the time dynamics indicated above. If the Court denies the motion for leave to amend, which it should not, Plaintiffs must file a new lawsuit, raising the same claims they would otherwise bring in this case, and seeking the same emergency relief in that lawsuit as well. Thus, by whatever path, timing is of the essence.

As shown more fully herein, Plaintiffs' request is timely and Plaintiffs have made every effort to file the Motion for Leave and Motion to Expedite immediately after their Managed Care Organizations ("MCOs") received the 2018 final bills for the HIPF on or after August 31, 2018. Payments for the 2018 HIPF are due on October 1, 2018. If Plaintiffs' Medicaid and CHIP MCOs pay their portions of the 2018 HIPF, this will trigger Plaintiffs' need to reimburse that 2018 HIPF liability so that Medicaid and CHIP contracts will be actuarially sound. This unfortunate result exists for the 2018 HIPF notwithstanding the Court's March 5, 2018 ruling regarding the Certification Rule.

Defendants primarily oppose Plaintiffs Motion for Leave on the grounds that Plaintiffs have failed to show good cause, Defendants would be prejudiced, and amendment would be futile. As discussed below, however, good cause exists to support Plaintiffs' request to amend, Defendants would not be unduly prejudiced, and amendment will not be futile because Plaintiffs have asserted a claim for which relief can be granted.

ARGUMENT

Courts "should freely give leave [to amend a complaint] when justice so requires." Fed. R. Civ. P. 15(a)(2). In fact, "[a] district court must possess a substantial reason to deny a request for leave to amend." *Smith v. EMC Corp.*, 393 F.3d 590, 595 (5th Cir. 2004) (internal quotation marks omitted). Those "substantial reasons" include "undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of the allowance of the amendment, [and] futility of the amendment." *Rosenblatt v. United Way of Greater Hous.*, 607 F.3d 413, 419 (5th Cir. 2010) (internal quotation omitted). None of the reasons for denying leave to amend are present here, and Plaintiffs have good cause to amend their complaint at this juncture of the litigation.

I. Plaintiffs Have Good Cause to Amend Their Complaint.

On October 1, 2018, Plaintiffs' Medicaid and CHIP MCOs will pay their assessed portion of the 2018 HIPF.[1] The process for calculating and distributing this liability for the 2018 HIPF began only a few months ago on April 17, 2018 when "covered entities" across the nation reported their overall health insurance premiums to the IRS. The IRS then began calculating the 2018 HIPF liability. This, of course, is all happening *after* the Court's ruling on March 5, 2018, affirming Plaintiffs' Congressional exemption from HIPF liability. *See Texas v. United States*, 300 F. Supp. 3d 810 (N.D. Tex. 2018). As the Court itself noted "the Court must 'presume that agencies will follow the law.'" *Id.* at 832 (citation omitted). This includes the IRS and the presumption that it will act (or not act) in a manner that fully honors the fact

[1] As the motion for temporary restraining order evidence will show, some Plaintiff States will reimburse their MCOs after the MCOs remit payment to the IRS, but at least one State, under the terms of its MCO contract, must reimburse its MCOs on September 25, 2018, before payment is made.

that Congress exempted Plaintiffs from HIPF liability. In as much as the Court embraces that presumption, Plaintiffs did too.

On or about June 15, 2018, the IRS remitted to Plaintiffs' Medicaid and CHIP MCOs a Letter 5066C—a notice of preliminary 2018 HIPF liability. It was at this time, and not before, that Plaintiffs were able to see that the IRS was calculating the 2018 HIPF liability based, in part, on premiums for Medicaid and CHIP.

Fearing that this calculation would ultimately result in 2018 HIPF liability, Plaintiffs wrote the IRS, protesting the preliminary calculations.[2] While the IRS did not respond directly to Plaintiffs' letters, the final 2018 HIPF liability statements (Letters 5067C), released on August 31, 2018, revealed whether the appropriate adjustments had been made.

Plaintiffs were able to review all of their Medicaid and CHIP MCOs' Letters 5067C after Labor Day. Upon review, Plaintiffs could see that the IRS did not adjust its calculations and intended to premise 2018 HIPF liability on Plaintiffs' Medicaid and CHIP capitation rates. Plaintiffs' actuaries confirmed that, even in the absence of the Certification Rule and Actuarial Standard of Practice 49 ("ASOP 49"), the assessment of 2018 HIPF liability upon Plaintiffs' Medicaid and CHIP capitation rates would result in 2018 HIPF liability upon Plaintiffs themselves.

At this point, and only at this point, Plaintiffs' course of action was clear. Only days later, Plaintiffs moved the Court to amend their complaint to address this threat. However, Plaintiffs were more timely than realistically possible. In the event that the IRS did not change course or alter its method of calculating the 2018 HIPF, Plaintiffs began preparing and shared the possibility of amending their complaint before the final bills from the IRS came out. Plaintiffs reached out to DOJ on

[2] These administrative protests were not a condition precedent to the filing of a new lawsuit or amending the complaint in this case.

Wednesday, August 29, 2018 to disclose Plaintiffs' intent to amend the complaint if the IRS did not make adjustments to the final 2018 HIPF bill notices.

Even though the Court declared the Certification Rule unlawful, as far as the 2018 HIPF is concerned, it is clear that the IRS regulations regarding its methodology of calculating the liability for the 2018 HIPF will cause HIPF tax payments by Plaintiffs' Medicaid and CHIP MCOs and those payments will have to be passed onto Plaintiffs in order for their MCO contracts to be actuarially sound. 42 U.S.C. § 1396b(m).

Clearly, as demonstrated above, the IRS could have prevented the need for Plaintiffs to amend their complaint by honoring the Court's March 5, 2018 ruling—which states that federal agency regulations cannot work to accomplish a result that Congress expressly forbids. Even without amending its regulations, the IRS was empowered to adjust its calculations to ensure that Plaintiffs' Medicaid and CHIP capitation rates were not included in its formulas. Alternatively, the IRS could have amended its regulations to make clear the need to exclude from the HIPF calculation the capitation rates Plaintiffs pay the MCOs for Medicaid and CHIP services.

Alas, in the end, IRS failed to take any action, much less respond to Plaintiffs' protests. Thus, there is a quickly closing window of time this month in which Plaintiffs may seek a temporary restraining order and preliminary injunction from the Court, asking it to stop Defendants from collecting the unlawfully collected 2018 HIPF.

Therefore, the clear record contrasts Defendants' claims of undue delay and failure to assert a good cause for the amendment. Plaintiffs were diligent in pursuing a remedy through non-litigation channels and the administrative process, and awaited a final administrative determination before raising this issue with the

Court.[3] Indeed, had Plaintiffs sought to bring an action regarding the 2018 HIPF liability earlier, before that liability was calculated or finally determined, Defendants could prospectively argue that any such dispute preceded final agency action.

Defendants allege that Plaintiffs could have brought their claims for injunctive and declaratory relief related to the 2018 HIPF about two years ago. *See* ECF No. 110 at 7. This statement is irrelevant because the statute of limitations to bring Administrative Procedure Act claims is six years, *Texas*, 300 F. Supp. 3d at 837–40, but it is also plagued with hindsight bias. First, Plaintiffs could not know if the 2018 HIPF would actually be imposed because moratoriums were issued for other fee years, including 2017 and 2019. *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. P, Title II, § 201, 129 Stat. 2242, 3037–38 (2015); H.R. 195, Division D – Suspension of Certain Health-Related Taxes, § 4003 (Jan. 22, 2018). Second, Plaintiffs had no way to know how the IRS would react, if at all, to the Court's March 5, 2018 ruling. Third, until the final bills were issued on August 31, 2018, Plaintiffs could not know if the IRS, in response to Plaintiffs' protests about the preliminary 2018 HIPF calculations, would appropriately adjust its calculations to ensure that the 2018 HIPF was not unlawfully assessed upon capitation rates for Plaintiffs' Medicaid and CHIP services.

Finally, in their proposed second amended complaint, Plaintiffs only assert claims for injunctive and declaratory relief with respect to the 2018 HIPF. Defendants claim on the one hand that these claims are related to the prior claims and should have been asserted before the deadline to amend pleadings on April 26, 2016, while arguing on the other hand that the claims are unrelated and would require the

[3] Neither the Supreme Court nor the Fifth Circuit employs a checklist for actions that do, or don't, qualify as "final agency action." Rather, it is both a "'flexible' and 'pragmatic'" inquiry. *Qureshi v. Holder*, 663 F.3d 778, 781 (5th Cir. 2011) (quoting *Abbott Labs. v. Gardner*, 387 U.S. 136, 149–50 (1967)).

reopening of discovery. *See* ECF No. 110 at 10–12, 18. Defendants misstate the reasons for the amendment.

First, Plaintiffs could not seek relief for a hypothetical injury that Congress or Defendants may or may not remedy in the years after the original complaint was filed. As discussed above, Plaintiffs diligently pursued an administrative remedy with the IRS, and only after being implicitly denied the requested relief from IRS did Plaintiffs request judicial relief. Second, as of August 31, 2018, it is now clear that the IRS is following the same regulations and methodology of calculating the 2018 HIPF that it followed for past HIPF years, and all without any apparent regard to the Court's March 5, 2018 ruling (or the fact that Congress exempted Plaintiffs from HIPF liability). As a result, the conduct complained of is IRS's refusal to revise its regulations and assessment of the 2018 HIPF to ensure that it does not result in the unlawful collection of the HIPF from Plaintiffs. Thus, Plaintiffs have good cause to amend their complaint.

II. Defendants Will Not Be Unduly Prejudiced by the Amendment.

The Fifth Circuit recognizes the undue prejudice of an amended complaint when a defendant would be required "to reopen discovery and prepare a defense for a claim different from the [claim] . . . that was before the court." *Smith*, 393 F.3d at 596 (quoting *Duggins v. Steak 'N Shake, Inc.*, 195 F.3d 828, 834 (6th Cir. 1999)). In this case, Defendants will suffer no such prejudice. In fact, Defendants have already asked the Court to stay a final judgment, and Defendants have spent two years preparing their case in defense of the HIPF for past fee years.

While Defendants may not wish to litigate the assessment and collection of the 2018 HIPF, they cannot show that they will be unduly prejudiced by the Court's examination of the merits of Plaintiffs' claims. Plaintiffs could file a brand new lawsuit over the 2018 HIPF and seek the same emergency relief, but because the

same parties have been litigating these issues for some time, it would be a waste of judicial resources to do so. Amendment allows the parties, who have already been briefing the merits of the HIPF to this Court for several years, to adjudicate the 2018 HIPF alongside prior years. This works to the benefit of Defendants, who do not have to litigate a new case in front of a new court on an emergency basis. Plaintiffs have sought relief from the unlawful imposition of the HIPF since the commencement of this lawsuit. The only difference at this juncture in the proceedings is the ripeness of Plaintiffs' claims for relief from the 2018 HIPF. Thus, amendment does not prejudice Defendants.

III. Plaintiffs Assert Claims for which Relief Can Be Granted.

Plaintiffs' claims are not futile because this Court may properly award the requested relief. Congress exempted the states from paying the HIPF. *Texas*, 300 F. Supp. 3d at 853 (citing ACA § 9010(c)(2)(B)); *see* 26 C.F.R. § 57(b)(2)(ii)(B). In calculating the 2018 HIPF liability, the IRS regulations fail to recognize or apply this exemption. The IRS recognizes other exemptions, but not the one that applies to Plaintiffs. 26 C.F.R. § 57.4(a)(4)(ii)–(iii). In other words, as will be discussed more fully in Plaintiffs' motion for temporary restraining order, IRS ignores statutory authority and the rulings of this Court and maintains a taxation scheme that violates the Administrative Procedure Act. Thus, if the Court enjoins Defendants from collecting the HIPF for fee year 2018, because IRS failed to cure its regulatory scheme, Plaintiff States will be safe from having to pay hundreds of millions of dollars to cover 2018 HIPF liability.

The Anti-Injunction Act ("AIA") does not bar the injunctive relief Plaintiffs seek here because they do not have a remedy for a refund under the IRC, as the Court has already adjudicated. *Texas*, 300 F. Supp. 3d at 836.

Nor should the Court countenance Defendants' argument that Plaintiffs' success in challenging the Certification Rule and availability of a disgorgement remedy undermines the applicability of *South Carolina v. Regan*, 465 U.S. 367 (1984). The Court was only able to order disgorgement because, "[u]nder the ACA, the sole avenue for challenging the HIPF is a "civil action[ ] for refund" by a covered MCO. ACA § 9010(f)(1). Plaintiffs cannot challenge the HIPF under the ACA because they are states, not MCOs." *Texas*, 300 F. Supp. 3d at 836.

Even if the Court's disgorgement ruling under the APA were to constitute a prospective alternate remedy, Defendants have appealed. Thus, appellate review is forthcoming and it is unclear whether the disgorgement remedy will be available to Plaintiffs once the Fifth Circuit, or perhaps even the Supreme Court, completes its review of this matter. Thus, as of this moment, it is not clear that "Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf." *Regan*, 465 U.S. at 381. Unless and until that clarity exists, Plaintiffs possess only the possibility of an alternate remedy, and this possibility—hotly contested by Defendants—should not be sufficient to preclude the Court from assuming jurisdiction over this matter and preserving the *status quo* until the appellate process is complete.

Previously, the Certification Rule worked to remove actuarial discretion and mandate the imposition of HIPF liability upon Plaintiffs for 2014, 2015, and 2016. The Court's ruling on the Certification Rule addressed Plaintiffs' claims for HIPF liability for 2014, 2015, and 2016, and disgorgement will remedy those harms.

But now, for 2018, even without the Certification Rule in place, another set of federal regulations and agency action (and inaction) is functioning to create the same result—the imposition of 2018 HIPF liability upon Plaintiffs. With no clear refund claim, and appellate review forthcoming regarding the Court's disgorgement order,

Plaintiffs seek to preserve the *status quo*—the current non-liability for the 2018 HIPF—and respectfully ask the Court to stop IRS from imposing its unlawful regulations and collecting an illegally calculated 2018 HIPF.

Further, Plaintiffs are likely to succeed on the merits of their claims because Defendants actions and inaction resulted in the unlawful imposition of the 2018 HIPF on Plaintiffs, and this Court has previously found that imposition of the HIPF on Plaintiffs' for prior fees years was unlawful.

CONCLUSION

Plaintiffs have good cause to amend their Complaint, and no substantial reason exists to deny Plaintiffs leave to amend. Thus, Plaintiffs respectfully request that the Court grant them leave to amend their complaint and order the Clerk of Court to filed the Second Amended Complaint on the docket. Plaintiffs also request that the Court render this order expeditiously so that Plaintiffs may move for a temporary restraining order.

Respectfully submitted this the 13th day of September, 2018.

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CERTIFICATE OF SERVICE

I hereby certify that on September 13, 2018, I electronically filed the foregoing document through the Court's ECF system, which automatically serves notification of the filing on counsel for all parties.

/s/ David J. Hacker
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