[EN BANC HEARING SCHEDULED FOR MAY 23, 2013]

No. 12-6294

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

HOBBY LOBBY STORES, INC.; MARDEL, INC.; DAVID GREEN; BARBARA GREEN; STEVE GREEN; MART GREEN; and DARSEE LETT,

Plaintiffs-Appellants,

v.

KATHLEEN SEBELIUS, in her official capacity as Secretary of Health and Human Services, *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA (No. 5:12-cv-01000) (Hon. Joe Heaton)

SUPPLEMENTAL BRIEF FOR THE APPELLEES

STUART F. DELERY
Acting Assistant Attorney General

SANFORD C. COATS
United States Attorney

BETH S. BRINKMANN
Deputy Assistant Attorney General

MARK B. STERN
ALISA B. KLEIN
(202) 514-1597
Attorneys, Appellate Staff
Civil Division, Room 7235
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases: **Page**

Statutes:

Regulations:

STATEMENT OF THE ISSUES

Plaintiffs challenge the requirement that the group health plan sponsored by Hobby Lobby Stores, Inc., and Mardel, Inc., include coverage of certain contraceptives ("the contraceptive-coverage requirement"). Pursuant to the Court's order, this supplemental brief addresses the following issues:

1. Whether Hobby Lobby Stores, Inc., and Mardel, Inc., as for-profit corporations organized under Oklahoma law, have standing, independent of the rights of their corporate shareholders, to challenge the contraceptive-coverage requirement under the Religious Freedom Restoration Act ("RFRA") or the Free Exercise Clause.[1]

2. Whether the individual plaintiffs have standing to challenge the contraceptive-coverage requirement under RFRA or the Free Exercise Clause.

3. Whether Hobby Lobby Stores, Inc., and Mardel, Inc., as for-profit corporations organized under Oklahoma law, have standing to assert the free exercise rights of their corporate shareholders, and whether the Supreme Court's associational standing decisions in *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471 U.S. 290, 303 n.26 (1985), and *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449, 458-459 (1958), are relevant to this question.

[1] We address this issue first because we believe that the corporations (but not the shareholders) have standing to challenge the contraceptive-coverage requirement.

4. Whether the Anti-Injunction Act, 26 U.S.C. § 7421(a), affects the Court's jurisdiction to entertain this suit at this time.

BACKGROUND

The Affordable Care Act generally provides that "[a] group health plan and a health insurance issuer offering group or individual health insurance coverage shall, at a minimum provide coverage for and shall not impose any cost sharing requirements for" certain specified preventive health services. 42 U.S.C. § 300gg-13(a). These include certain preventive health services recommended by the United States Preventive Services Task Force, *see id*. § 300gg-13(a)(1), certain immunizations, *see id*. § 300gg-13(a)(2), and, "with respect to women, such additional preventive care and screenings . . . provided for in the comprehensive guidelines supported by the Health Resources and Services Administration [("HRSA")]," *id*. § 300gg-13(a)(4). HRSA is a component of the Department of Health and Human Services.

Pursuant to this statutory delegation, HRSA has recommended, among other things, "'[a]ll Food and Drug Administration [("FDA")] approved contraceptive methods, sterilization procedures, and patient education and counseling for all women with reproductive capacity,' as prescribed by a provider." *Group Health Plans and Health Insurance Issuers Relating to Coverage of Preventive Services Under the Patient Protection and Affordable Care Act*, 77 Fed. Reg. 8725, 8725

(Feb. 15, 2012). Accordingly, subject to certain exceptions, non-grandfathered group health plans and health insurance issuers are required to include coverage for these services without cost-sharing for plan years beginning on or after August 1, 2012. *See id*. at 8725-8726.

ARGUMENT

A. The Corporations Have Standing To Challenge The Contraceptive-Coverage Requirement Under RFRA Or The Free Exercise Clause.

Plaintiffs seek to challenge the requirement that the group health plan sponsored by Hobby Lobby, Inc., and Mardel, Inc., include coverage of certain contraceptives. The corporations have standing to challenge this requirement because the corporations are required to ensure that the plan provides contraceptive coverage and the corporations' funds are used to help pay for the plan.

Our brief explains that the corporations cannot state a claim under RFRA or the Free Exercise Clause because (inter alia) the corporations are not persons engaged in the exercise of religion. That is a reason to reject the corporations' claims on the merits, rather than to dismiss their claims for lack of standing.

B. The Individual Shareholders Do Not Have Standing To Challenge The Contraceptive-Coverage Requirement Under RFRA Or The Free Exercise Clause.

The individual shareholders do not have standing to challenge the contraceptive-coverage requirement under RFRA or the Free Exercise Clause. The contraceptive-coverage requirement does not require the shareholders as

individuals to do anything. *See* Gov. Br. 23-29. Thus, the contraceptive-coverage requirement does not cause the shareholders any injury that could establish their standing to challenge that requirement under RFRA or the Free Exercise Clause.

Our brief explains that "[a] basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003). The Supreme Court has emphasized that "incorporation's basic purpose is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 163 (2001).

A corollary to this principle is that, "[g]enerally, any conduct harming 'a corporation confers standing on the corporation, not its shareholders.'" *Bartel v. Kemmerer City*, 482 Fed. App'x 323, 326 (10th Cir. 2012) (unpub.) (quoting *Bixler v. Foster*, 596 F.3d 751, 756 (10th Cir. 2010), and citing *Diva's Inc. v. City of Bangor*, 411 F.3d 30, 42 (1st Cir. 2005)). "Generally, courts allow a shareholder to sue only where there is a direct injury to the shareholder in his or her individual capacity, independent of any duty owed the corporation." *Kush v. American States Ins. Co.*, 853 F.2d 1380, 1383 (7th Cir. 1988).

This "shareholder standing rule applies even if the plaintiff is the sole shareholder of the corporation." *Potthoff v. Morin*, 245 F.3d 710, 716 (8th Cir.

2001) (citing *Canderm Pharmacal, Ltd. v. Elder Pharmaceuticals, Inc.*, 862 F.2d 597, 603 (6th Cir. 1988)); *see also, e.g.*, *Diva's Inc.*, 411 F.3d at 42 (same); *Erlich v. Glasner*, 418 F.2d 226, 228 (9th Cir. 1969) ("even though a stockholder owns all, or practically all, of the stock in a corporation, such a fact of itself does not authorize him to sue as an individual").

Moreover, this shareholder standing rule applies even where—unlike here—an injury to the corporation diminishes the value of the shareholder's stock and thus causes the shareholder injury that is concrete and personal. "The derivative injury rule holds that a shareholder (even a shareholder in a closely-held corporation) may not sue for personal injuries that result directly from injuries to the corporation." *In re Kaplan*, 143 F.3d 807, 811-812 (3d Cir. 1998) (Alito, J.). The "corporate form confers many advantages, in return for which the shareholder relinquishes several prerogatives, 'including that of direct legal action to redress an injury to him as primary stockholder in the business.'" *Potthoff*, 245 F.3d at 717 (quoting *Kush*, 853 F.2d at 1384). A shareholder "'may not move freely between corporate and individual status to gain the advantages and avoid the disadvantages of the respective forms.'" *Ibid*. (quoting *Kush*, 853 F.2d at 1384).

"While this rule, which recognizes that corporations are entities separate from their shareholders in contradistinction with partnerships or other unincorporated associations, is regularly encountered in traditional business

litigation, it also has been uniformly applied on the infrequent occasions it has arisen in suits against the state for statutory or constitutional violations." *Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel*, 20 F.3d 1311, 1317 (4th Cir. 1994). Thus, courts of appeals have repeatedly applied the shareholder standing rule to bar constitutional claims alleged pursuant to 42 U.S.C. § 1983. *See, e.g.*, *Diva's Inc. v. City of Bangor*, 411 F.3d 30, 42 (1st Cir. 2005) ("we join the circuits who have already addressed the issue to hold that this standing requirement also applies to actions brought to redress injuries to a corporation under Section 1983"); *Potthoff v. Morin*, 245 F.3d 710, 717 (8th Cir. 2001) (holding that the shareholder standing rule applies to civil rights actions brought pursuant to § 1983); *Flynn v. Merrick*, 881 F.2d 446, 450 (7th Cir. 1989) ("Filing suit under 42 U.S.C. § 1983 does not diminish the requirement that the shareholder suffer some individual, direct injury."); *Gregory v. Mitchell*, 634 F.2d 199, 202 (5th Cir. 1981) (extending shareholder standing rule to civil rights actions under § 1983); *Erlich v. Glasner*, 418 F.2d 226, 228 (9th Cir. 1969) (finding "nothing in the Civil Rights Act" that would permit a plaintiff-stockholder to circumvent the rule that, "even though a stockholder owns all, or practically all, of the stock in a corporation, such a fact of itself does not authorize him to sue as an individual").

In *Diva's Inc*., for example, the First Circuit held that the sole shareholder of a corporation that operated an adult entertainment bar lacked standing to claim that local officials had denied the corporation a special amusement permit in violation of her rights under the First and Fourteenth Amendments. *See Diva's Inc*., 411 F.3d at 35, 42.

Similarly, in *Potthoff*, the sole shareholder of a corporation alleged that the termination of the corporation's leasing agreement violated his rights under the First and Fourteenth Amendments. *See Potthoff*, 245 F.3d at 712-714. The Eighth Circuit dismissed the shareholder's claim on standing grounds because the termination of the corporation's leasing agreement did not cause the shareholder any "cognizable injury" that was "distinct from the harm" to the corporation rather than derivative of that harm. *Id*. at 717-718.

Likewise, in *Smith Setzer*, the Fourth Circuit dismissed a shareholder's claim under the Privileges and Immunities Clause because the shareholder did "not show the type of individualized harm that is necessary to support such a claim." *Smith Setzer*, 20 F.3d at 1317. "Instead, all injury is merely 'derivative' of the injury to the corporation, which is not constitutionally cognizable under the Privileges and Immunities Clause." *Ibid*. The Fourth Circuit explained that, although the shareholder wished "to discard the separate entity doctrine in this instance, such an action would vitiate the established rule against corporate standing in its entirety,

while disregarding settled theory of corporate law." *Id*. at 1317-1318 (followed in *Chance Management, Inc. v. State of South Dakota*, 97 F.3d 1107, 1115 (8th Cir. 1996)).[2]

These tenets of corporate law foreclose plaintiffs' contention that the regulation of the Hobby Lobby group health plan may be regarded as injury to the shareholders in their personal capacities. The contraceptive-coverage requirement does not cause any "'direct injury to the shareholder in his or her individual capacity'" that could establish a shareholder's standing to sue. *Potthoff*, 245 F.3d at 717 (quoting *Kush*, 853 F.2d at 1383). The corporation itself—rather than the shareholders—is the proper plaintiff in a suit like this one, which challenges a corporate regulation.

C. The Corporations Do Not Have Standing To Assert RFRA Or Free Exercise Clause Claims On Their Shareholders' Behalf.

1. The principles of associational standing that are reflected in the Supreme Court's decisions in *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471

[2] The Fourth Circuit further explained that the fact that a corporation is "a 'subchapter S' corporation is of no matter." *Smith Setzer*, 20 F.3d at 1318. "While an S corporation is treated differently for taxation purposes, it remains a corporation in all other ways, and it and its shareholders are separate entities." *Ibid*. The Fourth Circuit thus addressed the question that the district court raised but did not resolve in *Newland v. Sebelius*, 881 F. Supp. 2d 1287 (D. Colo. 2012). *See id*. at 1296 (asking whether a corporation's status as an S corporation would be a basis "to 'pierce the veil' and disregard the corporate form"); *appeal pending*, No. 12-1380 (10th Cir.).

U.S. 290, 303 n.26 (1985), and *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449, 458-459 (1958), do not permit the corporations to assert a RFRA or Free Exercise Clause challenge to the contraceptive-coverage requirement on their shareholders' behalf. It is well established that, "[e]ven in the absence of injury to itself, an association may have standing solely as the representative of its members." *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 342 (1977) (internal quotation marks and citations omitted). "[A]n association has standing to bring suit on behalf of its members when: (a) its members would otherwise have standing to sue in their own right; (b) the interests it seeks to protect are germane to the organization's purpose; and (c) neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." *Id*. at 343; *see also, e.g.*, *Southern Utah Wilderness Alliance v. Office of Surface Mining Reclamation and Enforcement*, 620 F.3d 1227, 1246 (10th Cir. 2010) (citing *Hunt*).

The Supreme Court's decisions in *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449 (1958), and *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471 U.S. 290 (1985), are illustrative. In *NAACP*, the Supreme Court held that the NAACP, which is a nonprofit membership corporation, 357 U.S. at 451, could "assert, on behalf of its members, a right personal to them to be protected from compelled disclosure by the State of their affiliation with the Association as revealed by the membership lists." *Id*. at 458.

Similarly, in *Tony and Susan Alamo Foundation v. Secretary of Labor*, 471 U.S. 290 (1985), the Court held that the Tony and Susan Alamo Foundation, which "is a nonprofit religious organization incorporated under the laws of California," *id*. at 292, had standing to assert a Free Exercise Clause claim on behalf of its "'associates,' most of whom were drug addicts, derelicts, or criminals before their conversion and rehabilitation by the Foundation." *Ibid*. The Foundation argued that the receipt of wages required by the Fair Labor Standards Act ("FLSA") "would violate the religious convictions of the associates," *id*. at 303, some of whom had "vigorously protested the payment of wages, asserting that they considered themselves volunteers who were working only for religious and evangelical reasons." *Id*. at 293. The Supreme Court held that the Foundation "has standing to raise the free exercise claims of the associates, who are members of the religious organization as well as employees under the Act." *Id*. at 303 n.26 (citing *NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449, 458-459 (1958)). The Court rejected the claim on the merits because the FLSA's minimum wage requirement does not "interfere with the associates' right to freely exercise their religious beliefs." *Id*. at 304-305.

These principles do not permit the corporate plaintiffs in this case to assert a RFRA or Free Exercise Clause claim on behalf of their shareholders. We are unaware of any Supreme Court decision that has applied the doctrine of

associational standing in the context of a for-profit corporation. But, even assuming that the doctrine of associational standing would extend to that context, the doctrine does not apply here because the shareholders do not "have standing to sue in their own right." *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 343 (1977). Therefore, this prerequisite for associational standing is not satisfied, and the corporations cannot assert RFRA or Free Exercise Clause claims on the shareholders' behalf.

2. We note that, in *EEOC v. Townley Eng'g & Mfg. Co.*, 859 F.2d 610, 619-620 & n.15 (9th Cir. 1988), and *Stormans, Inc. v. Selecky*, 586 F.3d 1109, 1120-21 & n.9 (9th Cir. 2009), the Ninth Circuit held that for-profit corporations had standing to assert Free Exercise Clause claims on behalf of their shareholders. In so ruling, the court overlooked the tenets of corporate law discussed above, which the Ninth Circuit did not discuss. The Ninth Circuit declared that a closely held corporation "is merely the instrument through and by which" the shareholders "express their religious beliefs," and that such a corporation "presents no rights of its own different from or greater than its owners' rights." *Townley*, 859 F.2d at 619-620. Citing the Supreme Court's decision in *Tony and Susan Alamo Foundation*, 471 U.S. at 303 n.26, the *Townley* court stated that the corporation "has standing to assert [the shareholders'] Free Exercise rights." *Id*. at 620 n.15; *see also Stormans*, 586 F.3d at 1120 (following *Townley*).

This reasoning cannot be reconciled with "incorporation's basic purpose," which is "to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 163 (2001). *See Conestoga Wood Specialties Corp. v. Sebelius*, __ F. Supp. 2d __, 2013 WL 140110, *7-8 (E.D. Pa. Jan. 11, 2013) (declining to follow *Townley* and *Stormans* for this reason), *appeal pending*, No. 13-1144 (3d Cir.); *see also Conestoga Wood Specialties Corp. v. Sebelius*, slip op. 3 (3d Cir. Feb. 7, 2013) (Garth, J., concurring) (explaining that the shareholders are, "'in both law and fact, separated by multiple steps from both the coverage that the company health plan provides and from the decisions that individual employees make in consultation with their physicians as to what covered services they will use'") (quoting *Grote v. Sebelius*, 708 F.3d 850, 858 (2013) (Rovner, J., dissenting)). The standing rulings in *Townley* and *Stormans* are incorrect and should not be followed here.

D. The Anti-Injunction Act Does Not Divest The Court Of Jurisdiction To Entertain This Suit At This Time.

The Anti-Injunction Act provides, with statutory exceptions inapplicable here, that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." 26 U.S.C. § 7421(a). "This statute protects the Government's ability to collect a consistent stream of revenue,

by barring litigation to enjoin or otherwise obstruct the collection of taxes." *NFIB v. Sebelius*, 132 S. Ct. 2566, 2582 (2012). "Because of the Anti-Injunction Act, taxes can ordinarily be challenged only after they are paid, by suing for a refund." *Ibid*. (citing *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1, 7–8 (1962)); *see also Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974). When the Anti-Injunction Act applies, it divests a court of subject-matter jurisdiction. *See Williams Packing*, 370 U.S. at 5.[3]

The fact that the Court is in a position where it could issue an injunction that would affect the assessment and collection of a tax is highly unusual. In most circumstances, the Anti-Injunction Act would deprive the Court of jurisdiction to hear the suit. We believe that the Anti-Injunction Act does not apply here, however, because of the unique statutory structure of 42 U.S.C. § 300gg-13(a) and 26 U.S.C. § 4980D.

The contraceptive-coverage requirement is the direct result of the Affordable Care Act's express delegation of an administrative determination to HRSA, a component of the Department of Health and Human Services. Congress required that group health plans provide coverage (without cost sharing) for several

[3] The Declaratory Judgment Act also excepts from its ambit suits for declaratory relief "with respect to Federal taxes." 28 U.S.C. § 2201. That exception "is at least as broad as the Anti-Injunction Act." *Bob Jones Univ. v. Simon*, 416 U.S. 725, 732 n.7 (1974).

categories of recommended preventive health services that Congress enumerated, such as recommended immunizations, and that "with respect to women" the requirement would extend to "such additional preventive care and screenings . . . provided for in the comprehensive guidelines supported by [HRSA]." 42 U.S.C. § 300gg-13(a)(4).

This suit effectively involves a challenge to the exercise of that delegated authority by HRSA. *See* 77 Fed. Reg. 8725, 8725 (Feb. 15, 2012) ("As relevant here, the HRSA Guidelines require coverage, without cost sharing, for '[a]ll Food and Drug Administration [(FDA)] approved contraceptive methods, sterilization procedures, and patient education and counseling for all women with reproductive capacity,' as prescribed by a provider."). That decision by HRSA triggers several non-tax enforcement consequences. It thus establishes a freestanding legal obligation and not just a predicate to imposition of a tax pursuant to the unique structure of 42 U.S.C. § 300gg-13(a) and 26 U.S.C. § 4980D. For example, because the requirement is part of the Affordable Care Act's amendments to the Public Health Service Act, the requirement applies to certain insurers, which are subject to the enforcement authority of the States or the Secretary of Health and Human Services. *See* 42 U.S.C. § 300gg-22. Those insurers are not subject to the tax that is authorized by 26 U.S.C. § 4980D, and thus could assert a pre-enforcement challenge to the contraceptive-coverage requirement without facing

an Anti-Injunction Act bar. *See also* 29 U.S.C. § 1132(a)(5) (authorizing enforcement by the Secretary of Labor).

The contraceptive-coverage requirement thus resulted from express delegated authority outside the Treasury Department, is enforced independently outside the Internal Revenue Code, and is subject to immediate challenge by other regulated entities. We believe these textual and structural aspects of the Affordable Care Act reflect congressional intent not to bar pre-enforcement challenges to HRSA-based requirements under the Anti-Injunction Act.[4]

[4] We note, however, that one district court concluded that, if the assessment authorized by 26 U.S.C. § 4980D is a tax, "then this Court would lack power to enjoin it, preliminarily or permanently, before its collection." *Autocam Corp. v. Sebelius*, 2012 WL 6845677, *10 (W.D. Mich. Dec. 24, 2012) (citing the Anti-Injunction Act), *appeal pending*, No. 12-2673 (6th Cir.).

Respectfully submitted,

STUART F. DELERY
Acting Assistant Attorney General

SANFORD C. COATS
United States Attorney

BETH S. BRINKMANN
Deputy Assistant Attorney General

/s/ Alisa B. Klein
ALISA B. KLEIN
MARK B.STERN
(202) 514-1597
Attorneys, Appellate Staff
Civil Division, Room 7235
U.S. Department of Justice
950 Pennsylvania Ave., N.W.
Washington, D.C. 20530

APRIL 2013

REQUIRED CERTIFICATIONS

I hereby certify to the following:

1. The electronic brief has been scanned for viruses using Microsoft Forefront Endpoint Protection (version 1.149.286.0) and found to be virus free.

2. The text of the electronic brief is identical to the text in the paper copies.

3. All required privacy redactions have been made.

4. On April 22, 2013, I electronically filed the foregoing brief with the Clerk of this Court by using the appellate CM/ECF system. In addition, I will cause twelve hard copies of the brief to be received by the Court within two business days of today. The participants in the case are registered CM/ECF users and service will be accomplished by the appellate CM/ECF system.

/s/ Alisa B. Klein
Alisa B. Klein