October 20, 2014

Centers for Medicare & Medicaid Services
Department of Health and Human Services
Attn: CMS-9940-P
P.O. Box 8010
Baltimore, MD 21244-1850

Re: Proposed Rule CMS-9940-P

Introduction

The legal definition of a "closely held" corporation often varies based on context and the benefit that such a status grants, and how this term is defined in the context of this Proposed Rule may have far-reaching implications. This letter is a comment on CMS-9940-P, the Proposed Rule addressing Coverage of Certain Preventive Services under the Affordable Care Act and the definition of "eligible organization" under the final regulations published in the Federal Register (78 FR 39870) on July 2, 2013 ("July 2013 final regulations"). I am currently in my third year at BU Law and anticipate earning my J.D. with a health law concentration in May 2015. I am also a staff member on the American Journal of Law & Medicine, for which I wrote a Note covering the cases which led to the Supreme Court's decision in *Burwell v. Hobby Lobby Stores, Inc.,* 134 S. Ct. 2751 (2014). The Court's decision in this case was a narrow one, and as such the definition of a closely held for-profit entity as an "eligible organization" should be similarly limited. Because the definition of a closely held for-profit entity in this context essentially grants corporations the First Amendment right to religious expression through the Free Exercise Clause under the Constitution of the United States, the definition should be narrow. In limiting those corporations that can qualify as "eligible organizations" under the July 2013 final regulations and imposing strict procedural requirements on those that do, religious expression can still be protected while also guarding against the possibility of the accommodations provided to "eligible organizations" being abused. A limited definition protects against the potential for discrimination

in the workplace based on the religious beliefs of business owners as well as noncompliance with other statutes and regulations based on the religious objections of a corporation. It would also respect the longstanding principles that have formed the body of corporate law in the United States. These principles include the protection of minority shareholders as well as the historical separation between the owners of a corporation and the entity they create. The ramifications a broad definition could have on the legal system and the economy in this country could be severe.

Comment

Provisions of the Proposed Regulations

Following the Supreme Court's decision in *Burwell v. Hobby Lobby Stores, Inc.* on June 30, 2014, the contraceptive coverage requirement added to the Public Health Service Act ("PHS Act") by the Patient Protection and Affordable Care Act ("ACA") cannot be applied to certain closely held for-profit entities under the Religious Freedom Restoration Act of 1993 ("RFRA"). Thus, the Departments of Health and Human Services ("HHS"), Labor, and the Treasury (collectively, "Departments") propose to amend the July 2013 final regulations to define an "eligible organization" to include "a closely held for-profit entity that has a religious objection to providing coverage for some or all of the contraceptive services otherwise required to be covered." Qualifying entities would be free from paying or arranging for contraceptive coverage, which would either be provided separately by an issue or arranged separately by a third party administrator.

In order to remain true to the Court's ruling in *Hobby Lobby*, the qualification and procedural requirements for meeting the definition of a closely held for-profit entity must be strict. The plaintiffs in *Hobby Lobby*, the Green family, and the associated case *Conestoga Wood Specialties Corp. v. Burwell*, the Hahn family, own and operate their businesses in accordance

with the shared religious beliefs and values of their owners as shown by their companies' statements of mission or purpose. In addition, both companies are not publicly traded. 134 S. Ct. at 2764-2766. Therefore, the definition of a closely held for-profit entity should be limited to these types of family-owned and operated businesses.

1. Defining a Closely Held For-Profit Entity

Closely held corporations, otherwise known as "close" or "closed" corporations, are commonly understood to be corporations the stock of which is not publicly traded and is held by a small number of owners. Black's Law Dictionary defines a close corporation as "[a] corporation whose stock is not freely traded and is held by only a few shareholders (often within the same family)." It also notes "the requirements and privileges of close corporations vary by jurisdiction." The Departments are proposing two possible definitions of a closely held for-profit entity. The first approach would define a closely held for-profit entity as "an entity where none of the ownership interests in the entity is publicly traded and where the entity has fewer than a specified number of shareholders or owners." The second approach would define a closely held for-profit entity as "a for-profit entity in which the ownership interests are not publicly traded, and in which a specified fraction of the ownership interest is concentrated in a limited and specified number of owners." While both approaches have precedent in federal law, the first approach most closely conforms with the Court's reasoning in *Hobby Lobby*.

The second approach may limit a substantial portion of a corporation's ownership to a small group, but the remaining portion could be divided amongst a much larger group of shareholders who could be forced to take religious positions they do not hold. The first approach, along with additional procedural requirements, has the potential to make the definition of a closely held for-

profit entity appropriately narrow in this context. As such, I will be commenting primarily on the first approach.

Defining a closely held for-profit entity by a maximum number of shareholders is supported by precedent at the state and federal level as well as empirical evidence. Professor F. Hodge O'Neal wrote a treatise on the characteristics of close corporations and how the corporate law surrounding them has developed over time. In it O'Neal defines a close corporation as one with shares that are "not generally traded in the securities market," placing an emphasis on the closeness of the relationship of the shareholders to the corporation and to each other. See Close Corporations: *Law and Practice.* By F. Hodge O'Neal (1958). O'Neal goes on to describe close corporations in more detail:

"A close corporation typically has the following attributes: **(1)** the shareholders are few in number, often only two or three; **(2)** they usually live in the same geographical area, know each other, and are well acquainted with each other's business skills; **(3)** all or most of the shareholders are active in the business, usually serving as directors or officers or as key men in some managerial capacity; and **(4)** there is no established market for the corporate stock, the shares not being listed on a stock exchange or actively dealt in by brokers; little or no trading takes place in the shares." F. O'Neal, Close Corporations §1.07 (1958).

An empirical study analyzing cases that involved piercing the corporate veil supports the idea of a very close relationship among a limited number of shareholders within close corporations. Professor Robert Thompson found that the veil piercing doctrine is one directed almost exclusively at close corporations, and that among those studied with individual shareholders that a large portion of them only had one, two, or three shareholders. See Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 Cornell L. Rev. 1036, 1055 (1991).

The Delaware Code defines a close corporation as an entity the stock of which is not publicly traded and is held by 30 or fewer shareholders. 8 Del.C. § 342. Electing to become a close corporation allows a business to deviate from management by a board of directors and allows shareholders to manage the company directly. Owners are also provided greater flexibility when it comes to internal corporate governance by being allowed to tailor their incorporation documents to their needs with provisions that can be informal and untraditional. Section 7.32 of the Revised Model Business Corporation Act ("RMBCA") provides for an agreement among the shareholders of a corporation to similarly do away with the board of directors and directly manage the company as long as the agreement is set forth in the articles of incorporation or bylaws and approved by all shareholders.

The history of subchapter S status under section 1631 of the Internal Revenue Code is relevant in this context as well. Close corporation status is often elected to provide shareholders with more direct control of the corporation. Subchapter S status is elected by close corporations and others primarily to avoid the corporate income tax. See Martin A. Rogoff, *Subchapter S and Selected Problems in Close Corporation Planning,* 26 MAINE L. REV. 1 (1974). Subchapter S is a special status for corporations that was historically very limited. It became less limited over time due to the lack of alternative corporate statuses available to business owners. Yet, today there are a variety of options available to avoid corporate income taxes, including the LLC. See *S Corporations - Their History and Challenges*, H.R. Rep. No. 109-57, 109th Cong., 2nd Session (2006). As such, the subchapter S requirements in place today are not relevant in the context of this Proposed Rule.

Subchapter S status is currently limited to corporations with 100 or fewer shareholders. However, when subchapter S was first added to the Internal Revenue Code in 1958 it was limited

to corporations with 10 or fewer shareholders. In 1976, Congress increased the limitation to 15 shareholders, then to 25 in 1981, 35 in 1982, and 75 in 1996 before reaching 100 in 2004. The remarks in the House of Representatives on The S Corporation Revision Act of 1999 provide some explanation for why this limitation has increased over time. Though not enacted, this Act targeted S Corporations by "improving their access to capital, preserving family-owned business, and lifting obsolete and burdensome restrictions that unnecessarily impede their growth." The banking community has also supported increasing the limitation on S Corporations. In a statement, the Independent Community Bankers of America explained: "[I]n many cases community banks have made a decision that their institutions are widely owned, often by the members of the communities they serve. The provisions of the S corporation rules limiting the number of shareholders to no more than 75 often forces community banks that wish to become an S corporation to disfranchise shareholders, severely limit[ing] ownership and its ability to raise capital in the future. Additionally, other business structures such as an LLP or LLC do not have any limitations on the number of owners. Unfortunately, community banks with more than 75 shareholders must somehow force out some of their shareholders—even when they would prefer to be more broadly held." Business owners continued to push for an increase in the limitation on the number of shareholders in an S Corporation, as it was one of the few options they had to receive special treatment for tax purposes. However, after regulations issued by the IRS in 1997, setting up an LLC has become much simpler. See 26 C.F.R Part 1. Today one simply has to "check the box" in order to decide what kind of taxable entity to create, allowing business owners a much easier way to avoid being subject to corporate income taxes.

As previously mentioned, Congress ultimately decided to increase the limit on the number of shareholders for S Corporations to 100 in 2004, while at the same time allowing members of the

same family to be treated as a single shareholder. Considering the benefit that closely held for-profit entities would be granted under the Proposed Rule, a limitation of 100 shareholders is not restrictive enough.

According to the IRS, there are over 4 million S corporations in the United States, 99.4% of which have 10 or fewer shareholders. Still, the restrictions on S Corporations in place today are inappropriate and irrelevant in the context of the Proposed Rule. **For purposes of obtaining an exemption from the contraceptive requirement of the ACA based on a religious objection, a closely held for-profit entity should be defined as an entity where none of the ownership interests in the entity is publicly traded and where the entity has 10 or fewer shareholders**. These shareholders should be limited to the same allowed under Subchapter S, namely individuals along with certain trusts and estates. This would account for Qualified Subchapter S Trusts and would not allow for other partnerships or corporations to be shareholders as they are in LLCs. In addition, members of the same family should be counted as separate shareholders. Congress began with this limitation in order to ensure that small businesses obtaining tax benefits were truly small. Both of the individual plaintiffs in *Hobby Lobby* and *Conestoga Wood* would still qualify for the exemption even after these new restrictions, as both companies are owned and controlled by a total of five family members. Thus, this number is appropriate to ensure that a closely held for-profit entity receiving an exemption from the law based on the religious beliefs of its owners is truly closely held.

2. Procedural Requirements

Religious Objection To Providing Coverage for Some or All of the Contraceptive Services Required To Be Covered

Close corporations have given majority shareholders the opportunity to oppress minority shareholders using a variety of methods over the years. Because the stock of close corporations are not publicly traded, minority shareholders cannot sell their shares and exit, making them particularly vulnerable to oppression. See Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 Georgetown L. J. 1208 (2008). Majority shareholders have utilized several techniques to freeze minority shareholders out from participating meaningfully in close corporations. They have withheld dividends and other returns on the investments of minority shareholders. They have terminated employment, management positions, and benefits. Majority shareholders have also taken disproportionate shares of corporate profits for themselves through excessive salaries, bonuses, and committing the corporation to generous contracts with themselves. They have even locked minority shareholders out of the premises and denied them access to corporate records. See O'Neal & Robert B. Thompson, *O'Neal and Thompson's Oppression of Minority Shareholders and LLC Members* § 1.03 (2d ed. 1997). Minority shareholder oppression within close corporations has taken place for decades, and should not be ignored in this context. As such, the Proposed Rule must include procedural requirements that ensure shareholders are in complete agreement regarding their religious objection in order to protect minority shareholders within a closely held for-profit entity.

The Supreme Court decided that the companies involved in *Hobby Lobby* could qualify for an exemption from the contraceptive requirement of the ACA because it would substantially burden the expression of their sincerely held religious beliefs, which is prohibited under the RFRA. A discussion on the sincerity of religious beliefs came up in *Hobby Lobby*. Though the corporations at issue in the case were not challenged on this issue, the Court still realized that it was worth

examining. The inquiry was fairly straightforward in *Hobby Lobby*. The five members of the Hahn family that own and control Conestoga Wood are all Mennonites. The company's "Vision and Values Statements" supports that Conestoga strives to "ensur[e] a reasonable profit in [a] manner that reflects [the Hahns'] Christian heritage." Conestoga's board also adopted a "Statement on the Sanctity of Human Life," which explains that the Hahns believe "human life begins at conception." and it is "against [their] moral conviction to be involved in the termination of human life."

The five members of the Green Family that own and control Hobby Lobby are all Evangelical Christians. The company's statement of purpose explains that the Greens are committed to "[h]onoring the Lord in all [they] do by operating the company in a manner consistent with Biblical principles." They too believe life begins at conception and therefore objected to the contraceptive requirement. In addition, each member of the family has signed a pledge to operate the business in accordance with the family's religious beliefs.

Thus, whether the religious beliefs held by the companies through their owners were sincere was fairly clear. Their beliefs were publicly disclosed in official corporate documents according to their governing structures. The Proposed Rule would require those corporations that qualify as closely held for-profit entities and want to object to the contraceptive requirement based on sincere religious beliefs of their owners to do so in accordance with their rules of governance. State law determines how a corporation can establish such rules. As such, valid corporate action stating the religious objection of a corporation's owners to the contraceptive requirement that is taken in accordance with their rules of governance and state law would establish a closely held for-profit entity's religious objection under the Proposed Rule.

There are additional issues that should be considered and addressed in the Proposed Rule. Perhaps the main issue is that of dissenters' rights. The procedural requirements under the Proposed Rule do not go far enough in protecting minority owners of illiquid shares. 100% of the shareholders involved in *Hobby Lobby* and *Conestoga* Wood agreed on their objection to the contraceptive requirement. While the members of both the Hahn and the Green family may all agree on their religious beliefs today, there may come a time in the future where there is disagreement.

In the context of religious beliefs, minority shareholder oppression is particularly concerning. For example, perhaps two members of the Hahn family decide to subscribe to a different religion than Christianity. Under normal rules of corporate governance, the majority could oppress the minority by forcing them to continue to support their religious objection, even if the minority shareholders no longer agreed with it. The best way to deal with such dissent is to ensure that there enough of a process in place to protect minority shareholders, even if it is only one or two family members in a closely held for-profit entity that are dissenting.

In the past, shareholders of a company were required to vote unanimously in favor of potential mergers and acquisitions. This essentially gave a single dissenting shareholder a veto power over the other shareholders. State legislation took this power away, and in return allowed dissenting shareholders to instead exchange their shares for a cash payment. Thus, those who do not wish to be part of a merger can remove themselves from it.

The Delaware Code contains a section on modern dissenters' rights. 8 Del.C. § 262. Many other states have also enacted statutes granting appraisal rights to dissenting shareholders who wish to receive a cash payment for their shares when a merger happens. This seems reasonable in the context of mergers and acquisitions, as they can often be in the best interest of a corporation and

have become more common over time. Allowing one shareholder to veto such a large business transaction may be inappropriate, so instead states have provided dissenting shareholders with other remedies. However, in the context of a corporation raising a religious objection based on the owners' sincerely held religious beliefs, requiring a unanimity through a shareholder vote is more than reasonable. If one shareholder of a closely held for-profit entity does not share the same faith as the others, how can the corporation express the religious beliefs of its owners sincerely? The Hahns and the Greens of Conestoga Wood and Hobby Lobby have been unanimous in their faith and in their corporate actions regarding contraception. In the face of complete agreement, public disclosure, and valid corporate action the Supreme Court decided not to challenge their sincerity and allowed them to obtain an exemption from the contraceptive requirement. Other companies wishing to do the same should have to hold a shareholder vote and be in complete agreement as well.

The Delaware Code, along with other state laws, allows a corporation's board of directors to take corporate action without a meeting upon unanimous written consent. 8 Del.C. § 141(f). The members of the board all sign a consent, then the secretary files it in the records book. If the action being taken is something the directors all agree on, a meeting should not be necessary. Likewise, if a corporation is raising an objection to the contraceptive requirement based on the sincere religious beliefs of its owners, they should all agree to the objection being made. Thus, a shareholder vote should be held requiring unanimous consent for the religious objection to be valid. Documentation of the decision-making process should also be required. **Requiring a unanimous shareholder vote in this context will protect dissenting shareholders while ensuring that religious objections raised by corporations are legitimate.** This vote should require annual certification in case new disagreements arise over time.

3. Disclosure Requirement

Harvard Law School professor Lucian Bebchuk, a proponent of putting additional processes in place to protect minority shareholders, has written extensively on corporate disclosure requirements in different contexts. See Lucian Bebchuk, *Shining Light on Corporate Political Spending,* 101 Georgetown L. J. 923 (2013). Privately held corporations such as Hobby Lobby have long enjoyed a great deal of discretion when it comes to deciding what kind of information to publicly disclose. Bebchuk argues that voluntary disclosure is inadequate, as the quality of information provided varies widely and is generally low. Public companies, on the other hand, are subject to mandatory laws regarding their financial statuses and operations. Companies that are privately owned are allowed to conceal information from the public and choose what they want to reveal about their inner workings. However, in the context of obtaining an exemption from the contraceptive requirement of the ACA there should be a **mandatory disclosure requirement.**

Public disclosure may be unnecessary, as it could raise concerns related to both corporate and constitutional law. In terms of providing information to the public about a religious objection to the contraceptive requirement, many companies may voluntarily decide to do so. Yet, as part of the process in obtaining an exemption from the contraceptive requirement, there should at least be a mandatory requirement for closely held for-profit entities to disclose their religious objection to the contraceptive requirement and their decision to obtain an exemption from it to their employees.

Closely held for-profit entities should provide their employees with this information out of fairness to them. The employees of a closely held for-profit entity obtaining an exemption from the contraceptive requirement will be impacted by this decision through a change in the

company's health plan. Employees should be given notice of this and the reasons behind the change. By disclosing how the decision was made and making employees aware of how they will be impacted, a greater balance can be achieved between closely held for-profit entities expressing their sincerely held religious beliefs and the employees who may or may not share those beliefs.

Additional Considerations

The limitations and procedures that I have outlined in this comment may be strict, but such restrictions are necessary in order to protect against an erosion of the fundamental principles of corporate law. Business owners choose to initially incorporate for many reasons. They gain several benefits from making the choice to form a separate entity. Most importantly, the corporate form provides greater security in the form of limited liability, as the corporation and its assets can shield individuals from becoming personally liable to creditors seeking to have their debts repaid. Considering everything that business owners gain from forming a corporation, the choice to do so should not be taken lightly. Corporations are distinct legal entities, separate from their owners, and should be treated as such unless certain requirements are met. Though corporations may now have a variety of statutory and constitutional rights, those rights should not be allowed to trump the rights of others.

Now that corporations can raise religious objections to the contraceptive requirement based on the beliefs of their owners, they may similarly object to other requirements in the future. Any exemptions granted to laws and regulations based on the religious objection of a corporation should be kept narrow in order to avoid this slippery slope: "The cases before this Court concern access to medical care, but the principle the Companies offer is not necessarily confined to employer-provided health insurance or medical services. The notion that a commercial business

sins when it complies with rules that decline to condemn the “sinful” independent conduct of its employees could apply just as well to the non-benefits portion of employee compensation – wages." Brief of *Amici Curiae* Lambda Legal Defense and Education Fund.

The body of corporate law in the United States is also at risk of being drastically altered if there is a broad exemption from the contraceptive requirement for closely held for-profit entities. Granting such an exemption could have both legal and economic effects. According to an *Amicus Curiae* Brief of Corporate and Criminal Law Professors filed in *Conestoga Wood*: "The separateness between shareholders and the corporation that they own (or, in this case, own and control) is essential to promote investment, innovation, job generation, and the orderly conduct of business. This Court should not adopt a standard that chips away at, creates idiosyncratic exceptions to, or calls into question this legal separateness." Allowing the corporate form to be completely permeable for religious purposes yet remain otherwise separate is an affront to our corporate law and goes against its history and principles.

Furthermore, the practice of "reverse veil piercing," which in this context would transfer the religious identity of a corporation's shareholders to the corporation itself, is one that should be guarded against. Business owners are generally not allowed to pierce the corporate veil for their own purposes: "The law strongly opposes insider reverse veil piercing. . . . veil piercing is a doctrine of equity, guided by equitable considerations, and reverse veil piercing at the request of an insider who has consciously chosen the corporate form by which to do business is hardly equitable." As such, the religious beliefs of the owners of a corporation should not be easily allowed to "pass through" to the corporation itself, nor should such beliefs provide a corporation with an easy out from complying with the law. By allowing these sorts of exemptions from laws

that are otherwise generally applicable, there is a danger that nearly all federal regulations could be objected to on religious grounds.

Following the Supreme Court's decision in *Hobby Lobby*, The Becket Fund has reported that there are currently 49 ongoing lawsuits challenging the contraceptive requirement that have been brought by for-profit corporations involving 193 individual plaintiffs. These include 22 family businesses, 3 bibles companies, and 14 corporations with women as co-owners. Out of the 49 for-profit lawsuits, 40 preliminary injunctions have been granted against the contraceptive requirement so that these companies do not have to comply with the requirement while their cases are still being decided.

These statistics provide a glimpse into the likely number of closely held for-profit entities that would seek an accommodation under the exemption in the Proposed Rule. Once this accommodation is finalized, many more for-profit companies could be encouraged to seek an exemption from the contraceptive requirement. As far as the number of participants and beneficiaries that are in the plans of such entities, they could range from the fewer than the 1,053 employees of Conestoga Wood to the over 18,000 employees of Hobby Lobby. The overall amount of companies, beneficiaries, issuers, and third-party administrators that will be affected by the Proposed Rule is difficult to quantify, though the Departments should strive "to make sure that any women affected by this decision will still have the same coverage of vital health services as everyone else," as the Obama Administration has stated.

Today, there is no requirement for nonprofit or for-profit entities to report whether they are making use of the accommodation, how many employees and families are impacted, or whether third-party issuers and administrators are complying with their obligations. Employees will need time to make any changes that may be necessary before their health plan's annual open

enrollment or renewal periods. As such, it is necessary for requirements to be put in place to ensure appropriate notice about when the accommodation is used and to report the amount of people affected by it. Such transparency would allow for effective oversight and enforcement, and provide important information to the employees of closely held for-profit entities with a religious objection to the contraceptive requirement. It would also allow the legislature, the courts, and the members of the public to determine whether this accommodation will work as intended.

To summarize, here is an example of what I have proposed in this comment:

(a) Closely held for-profit entity defined

For purposes of this rule, the term "closely held for-profit entity" means a corporation which does not:

(1) have more than 10 shareholders, and

(2) have as a shareholder a person (other than an estate or trust) who is not an individual.

(b) Special rules for closely held for-profit entities

(1) Members of a family treated as separate shareholders

For purposes of section (a)(1), the following shall be treated as separate shareholders:

(A) a husband and wife (and their estates), and

(B) all members of a family (and their estates).

(2) Procedural requirements for closely held for-profit entities with religious objections

For purposes of this rule, any closely held for-profit entity seeking to obtain an accommodation as an "eligible organization" shall:

(A) provide all shareholders with documentation supporting its religious objection to this rule,

(B) conduct a shareholder vote on its religious objection requiring consent from all shareholders,

(C) document the results of the vote on its religious objection, and

(D) annually recertify its religious objection to this rule.

(3) Disclosure requirements for closely held for-profit entities

Following a decision made through the process outlined in section (b)(2), a closely held for-profit entity shall disclose the following to its shareholders and employees:

(A) the reasons behind the decision that was made,

(B) the changes that will take place as a result of the decision, and

(C) the amount of people that will be affected by the decision.

Conclusion

The future of how for-profit corporations with religious owners will operate is still unclear. A broad exemption from the contraceptive requirement for closely held for-profit entities could vastly alter the corporate landscape that we know. In order to protect minority shareholders and preserve well-established principles of corporate law, any exemption that is granted should be a narrow one.

Thank you,

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