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Employee Benefits & Executive Compensation ADVISORY ■

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The Supreme Court's *Hobby Lobby* Decision: What Employers, Insurers and TPAs Need to Know

In its long-awaited ***Hobby Lobby*** decision (***Burwell v. Hobby Lobby Stores, Inc.***), issued on June 30, 2014, the Supreme Court held 5–4 that the Department of Health and Human Services' (HHS) preventive care mandates regarding contraceptive coverage issued under the Affordable Care Act (ACA) violate the Religious Freedom Restoration Act (RFRA) when applied to closely held, for-profit corporations that hold sincere religious beliefs against such coverage. This decision has generated headline news and considerable commentary, including whether it will have broader implications. This advisory focuses on the practical implications of the decision for group health plans, employers, insurers and third-party administrators (TPAs).

The HHS Contraceptive Mandate[1]

The ACA requires most non-grandfathered employer group health plans to cover "preventive care and screenings" for women without "any cost sharing requirements." ACA did not specify the types of preventive care that plans must provide, but instead authorized the Health Resources and Services Administration (HRSA), a sub-agency of HHS, to make this determination. In August 2011, HRSA issued preventive care guidelines for women that required nonexempt employers to provide "coverage, without cost sharing" for "[a]ll Food and Drug Administration approved contraceptive methods, sterilization procedures, and patient education and counseling."

Pursuant to HHS regulations, HRSA exempted group health plans sponsored by "religious employers" (and insurance coverage relating to such plans) from the contraceptive coverage requirements. A "religious employer" is an organization that is organized and operated as a nonprofit entity, and is described in Section 6033(a)(3)(A)(i) or (iii) of the Internal Revenue Code. Those sections refer to churches, their integrated auxiliaries, and conventions of churches and the exclusively religious activities of any religious order. HHS regulations also provide a process by which "eligible

[1] Note, we refer here to the "HHS mandate" as that is the reference used by the Court. The ACA preventive care requirements, like other ACA market reforms, are incorporated by reference into the Internal Revenue Code and ERISA. As a result, similar regulations were issued by the Departments of Treasury and Labor, including incorporating the HRSA guidelines, the religious employer exception, and the accommodation for eligible organizations. These regulations, as applied to closely held corporations, are also affected by the Court's decision.

organizations" may obtain an accommodation with respect to the contraceptive coverage requirements with respect to a group health plan of the organization.[2] An eligible organization is an organization that:

- opposes providing coverage for some or all of any otherwise required contraceptive services on account of religious objections;
- is organized and operates as a nonprofit entity;
- holds itself out as a religious organization; and
- self-certifies, in a form and manner specified by HHS, that it qualifies for the accommodation.

If an eligible organization provides the certification to the insurer or TPA, then the insurer or TPA must provide or arrange for the contraceptive coverage without charging the employee or the employer. HHS regulations also include a process by which insurers and TPAs may be at least partially reimbursed for providing such coverage.

The Court's Decision in a Nutshell

The RFRA prohibits the federal government from "substantially burden[ing] a person's exercise of religion even if the burden results from a rule of general applicability" unless the federal government can demonstrate that the application of the burden to the person: (1) furthers a compelling governmental interest; and (2) is the least restrictive means of furthering that compelling interest.

The Court concluded that the mandate failed to meet the "least restrictive means" prong of the test, as follows:

- The HHS mandate imposes a substantial burden on the exercise of religious beliefs, because an employer that offers coverage that does not comply could be subject to a $100 per–person, per-day penalty (under Code Section 4980D), an estimated $1.3 million per day for Hobby Lobby, and an employer that decides instead to not offer coverage could be subject to substantial penalties under the employer pay or play penalties (Code Section 4980H), an estimated $26 million a year for Hobby Lobby.
- The mandate is not the least restrictive means of furthering the government's compelling interest. The Court noted that HHS itself had developed a less restrictive means of fulfilling that interest—the accommodation provided for eligible organizations. (As noted below, the accommodation is the subject of other litigation.)

In reaching its decision, the Court rejected a number of arguments made by HHS, including arguments that the RFRA does not apply to corporations and that the RFRA does not apply to for-profit entities. In particular, the Court noted that the RFRA applies to nonprofit corporations, and therefore corporate entities are not excluded merely by being corporations. Similarly, the RFRA applies to individuals who are pursuing a profit motive, and therefore the for-profit motive is insufficient to exclude the application of the RFRA. The Court noted that individuals who would otherwise receive the protection of the RFRA do not have to choose between the RFRA protections and the ability to incorporate their enterprise.

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[2] These exceptions apply only in the group plan market, not to individual health insurance coverage.

Practical Impact of the Decision

The decision applies to a limited class of employers.

The Court held that, under the RFRA, closely held corporations are not required to comply with the contraceptive coverage mandate with respect to methods of contraception that violate the sincerely held religious beliefs of the companies' owners.

The Court does not define what it means to be a "closely held corporation." However, the three corporations in the case were all family owned and operated. As described in the Court's decision, a single family exercises sole ownership of Conestoga Wood Specialties, controls its board of directors and holds all of its voting shares. One of the sons of the founder of the company serves as the president and CEO. The two other companies, Hobby Lobby and Mardel, are owned by members of the same family. Again, according to the Court, a husband, wife and their children retain exclusive control of both companies. These individuals serve as the CEO, president, vice president and vice CEO. The two companies are operated through a management trust, of which each member of the family serves as trustee.

Thus, who controls the company appears to be a consideration in whether a company is closely held, such that the beliefs of the owners are reflected by the company. Size does not appear to be a factor—either in terms of the number of employees or the receipts or income of the company. The latter is not mentioned by the Court, and the Hobby Lobby stores together have more than 13,000 employees.

In order for a closely held corporation to be exempt from the contraceptive coverage requirement, the requirement must run afoul of the owners' "sincerely held religious beliefs." In determining whether this standard is met, the Court declined to impose its judgment with respect to the beliefs of the owners, saying that "it is not for us to say that [the owners'] religious beliefs are mistaken or insubstantial." Note, however, that the Court discussed various organizational and other documents relating to the companies that stated the values of the owners.

While some of the Court's discussion could potentially be applied to publicly held corporations, the decision does not reach that far. The Court made that clear in stating that it had "no occasion…to consider RFRA's applicability to such companies." Thus, the applicability of the RFRA to publicly held corporations is still an open question.

The decision does not affect "religious employers" as described above, who remain exempt from the HHS mandate.

The decision also does not affect the ability of "eligible organizations" as defined in HHS regulations to avail themselves of the religious accommodation described above. The Court's decision leaves this accommodation intact, and in fact refers to it as a way that HHS might accommodate the religious beliefs of closely held companies, while still ensuring that their employees have access to contraceptive coverage. [Note that the certification requirement under the accommodation is the subject of separate litigation, ***see, e.g., Little Sisters of the Poor v. Sebelius*** (which involves self-funded church plans), so further developments may be forthcoming.]

The decision appears broad enough to cover all required contraceptive methods.

As the Court noted, the employers only objected to four contraceptive methods and did not object to the other 16 FDA-approved contraceptive methods required under HHS' regulations. However, the Court's decision was based upon the objections to the contraceptive mandate due to sincerely held religious beliefs. The nature of the beliefs,

rather than the particular contraceptive methods involved, appears to be at the core of the decision. Thus, under the decision, a closely held corporation that objects to providing any of the required methods of contraception based on sincerely held religious beliefs may be able to claim exemption for those methods to which it objects.

The decision raises some additional issues for fully insured plans.

Many states have their own contraceptive coverage mandates, independent of the ACA and federal regulations. Many, but not all, have a religious exception, which may or may not be co-extensive with federal requirements. Insurers are generally subject to both state insurance laws (including state law benefit mandates) and the ACA. The ***Hobby Lobby*** decision does not apply to state laws, but by its terms is limited to federal regulation under the RFRA. Further, as the Court noted, although when originally enacted in 1993 the RFRA applied to state laws, the Supreme Court later found application of the RFRA to states was unconstitutional, and Congress subsequently modified the RFRA to eliminate its application to state law.

State law also impacts fully insured plans through the ACA enforcement structure, which is the same as that under HIPAA. Thus, with respect to health insurance issuers, enforcement of ACA requirements is primarily at the state level, and HHS assumes enforcement responsibility only if a state fails to substantially enforce applicable requirements. At this time, a majority of states have indicated they will enforce the ACA, and HHS has assumed enforcement responsibility under the ACA for a handful of states that have indicated they will not do so – Alabama, Missouri, Oklahoma, Texas and Wyoming (as of January 1, 2014). The manner in which states have adopted the ACA (e.g., through enactment of a similar law) or otherwise enforce the ACA requirements differs from state to state.

Insurers will need to review state law requirements, including independent contraceptive coverage mandates and those that flow through from the ACA, to determine what state law continues to apply and how state laws will be enforced. State Departments of Insurance may provide guidance on these issues.

Due to ERISA's preemption provisions, state law benefit mandates do not apply to self-funded plans, so these issues do not arise with respect to such plans.

The decision does not impact "grandfathered" health plans.

Plans that are grandfathered plans under the ACA are not required to provide preventive care pursuant to the ACA. Thus, the decision does not impact any plan that maintains grandfathered status under ACA.

The decision does not impact other ACA requirements.

The Court makes it clear that its decision does not implicate other ACA requirements or regulations. The Court states: "[O]ur decision in these cases is concerned solely with the contraceptive mandate. Our decision should not be understood to hold that an insurance coverage mandate must necessarily fall if it conflicts with an employer's religious beliefs. Other coverage requirements, such as immunizations, may be supported by different interests (for example, the need to combat the spread of infectious diseases) and may involve different arguments about the least restrictive means of providing them."

What's Next?

Although answering some questions, the ***Hobby Lobby*** decision also leaves many questions unanswered. A core question is what will be the government's response? The Court opened the door to HHS to extend the religious accommodation currently applicable to certain nonprofit employers to closely held corporations that are affected by the decision. However, until HHS acts, there is no requirement for closely held companies, insurers or TPAs to follow that approach. Rather, under the decision, closely held companies may claim exemption from the HHS contraceptive coverage mandate based on their sincerely held religious beliefs. Going forward, this may change if new regulations are issued. There may be some issues as to whether some particular organizations are "closely held." Insurers may need to determine what obligations continue to be imposed under state law. There are other cases pending that relate to other aspects of the mandate, e.g., the self-certification requirement, so further case law developments are expected.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Members of Alston & Bird's Employee Benefits & Executive Compensation Group

Robert A. Bauman
202.239.3366
bob.bauman@alston.com

Saul Ben-Meyer
212.210.9545
saul.ben-meyer@alston.com

Stacy C. Clark
404.881.7897
stacy.clark@alston.com

Emily Seymour Costin
202.239.3695
emily.costin@alston.com

Patrick C. DiCarlo
404.881.4512
pat.dicarlo@alston.com

Ashley Gillihan
404.881.7390
ashley.gillihan@alston.com

David R. Godofsky
202.239.3392
david.godofsky@alston.com

John R. Hickman
404.881.7885
john.hickman@alston.com

H. Douglas Hinson
404.881.7590
doug.hinson@alston.com

Emily C. Hootkins
404.881.4601
emily.hootkins@alston.com

James S. Hutchinson
212.210.9552
jamie.hutchinson@alston.com

Johann Lee
202.239.3574
johann.lee@alston.com

Blake Calvin MacKay
404.881.4982
blake.mackay@alston.com

Emily W. Mao
202.239.3374
emily.mao@alston.com

Steven C. Mindy
202.239.3816
steven.mindy@alston.com

Craig R. Pett
404.881.7469
craig.pett@alston.com

Earl Pomeroy
202.239.3835
earl.pomeroy@alston.com

Jonathan G. Rose
202.239.3693
jonathan.rose@alston.com

Syed Fahad Saghir
202.239.3220
fahad.saghir@alston.com

Thomas G. Schendt
202.239.3330
thomas.schendt@alston.com

John B. Shannon
404.881.7466
john.shannon@alston.com

Richard S. Siegel
202.239.3696
richard.siegel@alston.com

Carolyn E. Smith
202.239.3566
carolyn.smith@alston.com

Michael L. Stevens
404.881.7970
mike.stevens@alston.com

Daniel G. Taylor
404.881.7567
dan.taylor@alston.com

Elizabeth Vaughan
404.881.4965
beth.vaughan@alston.com

Kerry T. Wenzel
404.881.4983
kerry.wenzel@alston.com

Kyle R. Woods
404.881.7525
kyle.woods@alston.com

ALSTON&BIRD LLP

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 12th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.756.3300 ■ Fax: 202.756.3333