FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FOOTHILL CHURCH, a California Non-Profit Corporation; CALVARY CHAPEL CHINO HILLS, a California Non-Profit Corporation; SHEPHERD OF THE HILLS CHURCH, a California Non-Profit Corporation, *Plaintiffs-Appellants*, v. MARY WATANABE[*], in her official capacity as Director of the California Department of Managed Health Care, *Defendant-Appellee.*	No. 19-15658 D.C. No. 2:15-cv-02165-KJM-EFB ORDER

Argued and Submitted November 20, 2020
Submission Vacated November 24, 2020
Resubmitted July 19, 2021
San Francisco, California

Filed July 19, 2021

[*] Mary Watanabe is substituted for her predecessor, Michelle Rouillard, as Director of the California Department of Managed Health Care. Fed. R. App. P. 43(c)(2).

Before: Jacqueline H. Nguyen, Andrew D. Hurwitz, and Daniel A. Bress, Circuit Judges.

Order;
Dissent by Judge Bress

SUMMARY[**]

Constitutional Law

In light of the U.S. Supreme Court's decision in *Fulton v. City of Philadelphia*, No. 19-123, 2021 WL 2459253 (June 17, 2021) (holding that the refusal of the City of Philadelphia to contract with Catholic Social Services for the provision of foster care services unless the agency agreed to certify same-sex couples as foster parents violated the Free Exercise Clause of the First Amendment), the panel vacated the district court's rulings on the Free Exercise and Equal Protection claims, and remanded for further consideration.

The panel addressed appellant's Establishment Clause claim in a concurrently filed memorandum.

Judge Bress dissented because he would hold that the panel should not have vacated and remanded without providing any guidance. He wrote that the panel's remand was a poor use of judicial resources that undervalued the significant constitutional injuries that the churches alleged. He would decide the appeal, and hold that the district court

[**] This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

erred in applying rational basis review, and the churches clearly stated a claim for relief under the Constitution's Free Exercise and Equal Protection Clauses. He would hold what the law pre- and post-*Fulton* plainly required: the Director of the California Department of Managed Care's broad discretionary authority to issue individualized exemptions from the abortion coverage obligation meant that the court must apply strict scrutiny to California's requirement that the churches' health plans cover elective abortions.

COUNSEL

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Karli A. Eisenberg (argued), Joshua N. Sondheimer, and Hadara R. Stanton, Deputy Attorneys General; Gregory D. Brown, Supervising Deputy Attorney General; Cheryl L. Feiner, Senior Assistant Attorney General; Office of the Attorney General, Sacramento, California; for Defendant-Appellee.

ORDER

We **VACATE** the district court's rulings on the Free Exercise and Equal Protection claims and **REMAND** for further consideration in light of *Fulton v. City of Philadelphia*, No. 19-123, 2021 WL 2459253 (June 17, 2021).

We address Appellant's Establishment Clause claim in a concurrently filed memorandum.

BRESS, Circuit Judge, dissenting:

The Director of the California Department of Managed Health Care requires that plaintiff churches offer elective abortions as part of their group health plans for church employees. The churches maintain that this violates their sincerely held religious beliefs. But the district court dismissed the churches' Free Exercise Clause claim, applying only deferential rational basis review under *Employment Division, Department of Human Resources of Oregon v. Smith*, 494 U.S. 872 (1990). The court today vacates the district court's order and remands for further consideration in light of the Supreme Court's recent decision in *Fulton v. City of Philadelphia*, 141 S. Ct. 1868 (2021). The court's order is a small step in the right direction. But it does not go nearly far enough—or move nearly fast enough—to address the significant constitutional violation that the churches plead and the patent legal error in the decision below.

Well before *Fulton*, the law was clear: when, as here, a government official has the discretionary power under a "good cause" standard to exempt a regulated entity from an

otherwise generally applicable regime (here, the requirement to include elective abortions in health plans), we must apply strict scrutiny to the government's determination to enforce its rule over a religious objection. *Fulton* neither created nor changed this long-established principle; it simply applied it. Vacating in light of *Fulton* without providing any guidance, as the court now does, effectively orders a re-do in the court below with no intervening change in the law. This is a poor use of judicial resources that undervalues the significant constitutional injuries that the churches allege. And it will inevitably produce even further delay in this protracted case, which the churches filed in 2015 and which was appealed to us in 2019.

We should have decided the appeal that was properly before us and held what the law pre- and post-*Fulton* plainly requires: the Director's broad discretionary authority to issue individualized exemptions from the abortion coverage obligation means that we must apply strict scrutiny to California's requirement that the churches' health plans cover elective abortions. Because our court declines to decide that clear issue of law and thereby prolongs the churches' efforts to obtain relief, I respectfully dissent.

I

This appeal arises from the district court's grant of California's motion to dismiss. I therefore recite the facts as stated in the churches' operative complaint. *See Nguyen v. Endologix, Inc.*, 962 F.3d 405, 408 (9th Cir. 2020).

The plaintiffs are three Christian churches in Southern California: Foothill Church, Calvary Chapel Chino Hills, and Shepherd of the Hills Church. The churches each employ more than fifty full-time employees. They allege that under federal law they must therefore provide health

insurance for their employees. As part of the teachings that govern their religious missions, the churches believe that elective abortion is a sin. In their view, because "all human life is sacred from the moment of conception to natural death," "abortion destroys an innocent human life and therefore violates biblical teachings." The issue in this case is whether California may nonetheless require the churches to include elective abortions in their employee health plans, which the churches maintain forces them to subsidize and facilitate conduct that violates their religious convictions.

Under California's Knox-Keene Health Care Service Plan Act of 1975, health care plans must provide coverage for "basic health care services." Cal. Health & Safety Code § 1367(i). The Director of the California Department of Managed Health Care (DMHC) interprets, administers, and enforces the Knox-Keene Act. DMHC regulations implementing the Act provide that "basic health care services" means "medically necessary" services. Cal. Code Regs. tit. 28, § 1300.67. Health plans generally provide for both medically necessary and elective abortions in plan contracts. But before August 22, 2014, DMHC had long allowed religious employers to purchase plans that did not cover elective abortions.

Things began to change in late 2013. In response to learning that two Catholic universities in California had removed elective abortion coverage from their employee health plans, abortion advocates urged the DMHC to stop permitting health plans under which religious employers could offer more limited abortion coverage options. Yielding to this request, the DMHC's Director eventually agreed to make a policy change.

On August 22, 2014, the Director sent letters to seven health plans that served religious organizations, instructing

that the plans now had to cover elective abortions. The Director explained she had determined that DMHC had "erroneously approved or did not object" to plan language limiting coverage for elective abortions, limitations that appeared only in health plans "covering a very small fraction of California health plan enrollees." The plan limitations on abortion coverage, the Director wrote, violated the Knox-Keene Act and other California laws.

The Director instructed the health plans promptly to remove from plan documents any limitations or exclusions on lawful elective abortions. This "include[d], but [was] not limited to, any exclusion of coverage for '*voluntary*' or '*elective*' abortions and/or any limitation of coverage to only '*therapeutic*' or '*medically necessary*' abortions." Health plans were required to file revised health plan documents with the DMHC within 90 days. The Director also rejected pending approval requests for health plans that did not provide coverage for elective abortions.

Although the Director issued her August 22, 2014 directive to the health plans, it most directly affected religious employers like the churches. Indeed, the complaint alleges that the DMHC was not aware of any non-religious employer that had purchased plans that limited coverage for elective abortions.

In August 2014, the Life Legal Defense Foundation wrote to the DMHC and asked it to reconsider its position. The Director responded that California law compelled its approach and that DMHC "will not reverse its position on the scope of required abortion coverage." In response to a November 2014 letter from a Commissioner on the U.S. Commission on Civil Rights, the Director again reiterated her view that California law required that health plans cover elective abortions.

In October 2015, the churches sued the Director challenging, as applied to them, the Director's interpretation of the Knox-Keene Act requiring the churches' employee health plans to provide coverage for elective abortions. As relevant to their Free Exercise Clause claim, the churches cited the Director's statutory authority to grant individualized exemptions from the Knox-Keene Act's "basic health services" requirement. These statutes, which are critical to the Free Exercise Clause analysis and which I will discuss further below, allow the Director to grant an exemption when there is "good cause" or when "in the public interest."

The churches also alleged that in October 2015, the Director had in fact used her discretionary authority to exempt another religious organization from the elective abortion requirement. That religious organization, unlike the plaintiff churches, teaches that elective abortions are permissible when a pregnancy results from rape or incest. Based on the Director's statutory discretionary exemption authority, the churches alleged that "[t]he Knox-Keene Act, as interpreted and applied by [the Director], is neither neutral nor generally applicable."

The district court twice dismissed the churches' complaint under Federal Rule of Civil Procedure 12(b)(6) but each time gave the churches leave to amend their Free Exercise Clause and related Equal Protection Clause claim. After the churches filed a second amended complaint, the district court dismissed it again, this time with prejudice. The district court held that the DMHC's elective abortion requirement was subject to rational basis review under *Employment Division v. Smith* because it was premised on a "neutral law of general applicability."

The district court acknowledged the Director's authority to issue individualized exemptions from the abortion coverage requirement. But the court determined that strict scrutiny did not apply because the churches' "allegations do not support a reasonable inference that the Director deliberately sought to give preference to one set of religious beliefs regarding abortion over others because reasonable alternate non-discriminatory explanations exist for the Director's actions." (Quotations omitted).

The churches filed their notice of appeal in April 2019. This appeal was fully briefed by January 2020, and we heard oral argument in November 2020. Shortly after oral argument, we issued an order vacating submission pending the Supreme Court's forthcoming decision in *Fulton*. The Supreme Court decided *Fulton* in June 2021.

Each side then submitted status reports on *Fulton* consistent with our prior order. In their status report, the churches ask that we now issue a decision reversing the district court and allowing the churches' lawsuit to proceed. In their view, "[a]nything else would waste judicial resources and prolong the irreparable harm being suffered by the churches for over six years now." For its part, California asks us to vacate the district court's decision in light of *Fulton*, so that "the district court can consider which standard of review to apply following *Fulton*."

Our court today goes with California's preferred approach. I respectfully disagree with that. And I am quite concerned that California has been giving the churches the run-around in an area where great sensitivity is warranted. The legal issue before us is straightforward. And merely vacating in light of *Fulton* unnecessarily prejudices the churches even further. I would have held that under longstanding precedent, the district court erred in applying

rational basis review. The churches have clearly stated a claim for relief under the Constitution's Free Exercise and Equal Protection Clauses.

II

The key feature of California's regime that takes it outside of rational basis review and places it squarely into strict scrutiny is the Director's broad discretion to grant exemptions from the Knox-Keene Act's "basic health care services" requirement. Under the Act, "[a] health care service plan contract shall provide to subscribers and enrollees all of the basic health care services . . . , *except that the director may, for good cause, by rule or order exempt a plan contract or any class of plan contracts from that requirement*." Cal. Health & Safety Code § 1367(i) (emphasis added). Under another provision, the Director may exempt persons or plans from relevant requirements when "in the public interest and not detrimental to the protection of subscribers, enrollees, or persons regulated under this chapter." *Id.* § 1343(b); *see also id.* § 1344(a) (substantially similar authority to waive requirements "in the public interest").

California fully agreed in its briefing before us that the Director possesses what California itself describes as "Individualized Exemption Authority." As California explained to us in its answering brief:

> The Director has authority to exempt Plan contracts from the requirement that they cover "all" basic health services for good cause. § 1367(i). And under certain circumstances, she may exempt Plans and Plan contracts from the Act or waive the

> requirements of any rule or form issued by the DMHC. §§ 1343(b), 1344(a).

Indeed, California clarified, the Director is authorized "to allow a Plan to exclude or limit coverage of particular services." Nevertheless, California maintained that the Director's discretionary exemption authority did not "mandate application of strict scrutiny under an 'individualized assessments exception to [*Employment Division v.*] *Smith*." According to California, "[t]his purported exception to *Smith* has no application here."

California's position, which the district court adopted, is clearly wrong. Under the Supreme Court's decision in *Employment Division v. Smith*, the right to freely exercise one's religion "does not relieve an individual of the obligation to comply with a valid and neutral law of general applicability on the ground" that it burdens religious exercise. 494 U.S. at 879. Such laws "need not be justified by a compelling governmental interest even if the law has the incidental effect of burdening a particular religious practice." *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 531 (1993) (discussing *Smith*). Instead, they are subject to rational basis review. *E.g.*, *Stormans v. Wiesman*, 794 F.3d 1064, 1075–76 (9th Cir. 2015).

But *Smith* identified an important (and not "purported") exception to its general approach: even in the context of otherwise generally applicable requirements, "where the State has in place a system of individual exemptions, it may not refuse to extend that system to cases of religious hardship without compelling reason." *Smith*, 494 U.S. at 884 (quotations omitted). Indeed, *Smith* specifically identified "good cause" as a standard that "created a mechanism for

individualized exemption" that would, in turn, demand strict scrutiny in its relevant applications. *Id.* (quotations omitted) (discussing *Sherbert v. Verner*, 474 U.S. 398 (1963)). As the Court later reiterated in *Church of the Lukumi Babalu Aye*, "in circumstances in which individualized exemptions from a general requirement are available, the government may not refuse to extend that system to cases of religious hardship without compelling reason." 508 U.S. at 537 (quotations omitted).

Under these precedents, there is no doubt that given the Director's discretionary authority to issue exemptions for "good cause" and when "in the public interest," a decision requiring the churches to have health plans that cover elective abortions must be reviewed under strict scrutiny. As our court has previously recognized, "an open-ended, purely discretionary standard like 'without good cause' easily could allow discrimination against religious practices or beliefs." *Stormans*, 794 F.3d at 1081. That is precisely why the Supreme Court treats laws with individualized exemption options differently than neutral laws of general applicability. And it further explains why the former must be reviewed under our most exacting constitutional standards when the allegation is that religious practice is burdened. Indeed, the "good cause" standard in California's Knox-Keene Act is exactly the same open-ended standard that *Smith* identified as the classic discretionary standard that takes a law outside of *Smith*'s general rule. *See Smith*, 494 U.S. at 884.

The district court did not apply *Smith*'s exception for individualized exemptions on the theory that the churches did not sufficiently allege that the Director "deliberately sought to give preference to one set of religious beliefs regarding abortion over others." But such a showing of "deliberate" discrimination was not required. Instead,

Smith's exception—and therefore strict scrutiny—applies "where the State has in place a system of individual exemptions" and "refuse[s] to extend that system to cases of religious hardship." *Smith*, 494 U.S. at 884 (quotations omitted); *see also Church of the Lukumi Babalu Aye*, 508 U.S. at 537–38 (strict scrutiny applies if the government makes individualized exceptions "available"). The churches have clearly alleged such a system here.

The district court therefore erred in dismissing the churches' Free Exercise Clause (and parallel Equal Protection Clause) claims under a rational basis analysis. The churches plainly stated a claim for relief, so that their lawsuit should have been allowed to proceed. And California should have been put to its rigorous strict scrutiny burden of showing a compelling interest in refusing the churches a religious accommodation—a compelling interest California has never identified.[1]

[1] At oral argument, California appeared to suggest that the problem here was simply that the churches' plans had never asked for exemptions on behalf of the churches. That position is meritless. The Director repeatedly stated in writing that she would not revisit the position set forth in her August 22, 2014 letters. And the parties in this case have been engaged in hard-fought litigation for nearly six years on the churches' Free Exercise Clause claim. There is no sense in which this long legal battle somehow stems from a miscommunication over whether California would grant the exemption the churches desire. It is obvious California is unwilling to do so. California's argument that the churches lack standing and that the case is not ripe is also squarely foreclosed by our recent decision in *Skyline Wesleyan Church v. California Dep't of Managed Health Care*, 968 F.3d 738, 747–53 (9th Cir. 2020). (I agree, however, that the district court properly dismissed the churches' Establishment Clause claim; California has established no kind of state religion here, nor would a reasonable observer so conclude. *See, e.g.*, *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012,

While unnecessary to state its Free Exercise and Equal Protection claims, I note that the churches nevertheless *did allege* that the Director had issued exemptions from the elective abortion requirement in a discriminatory manner. Specifically, the churches alleged that in October 2015—the same month the churches filed this lawsuit—the DMHC approved (for a different religious employer) a plan exemption that excluded elective abortions except for rape and incest and to save the life of the mother.

California in its briefing fully acknowledged that "the Director has since disclosed that the DMHC had granted the exemption allowing a Plan to offer coverage to 'religious employers' that limited coverage of abortion." But California tries to use this point in its favor, claiming that it shows the Director's "willingness to accommodate, rather than target, religious objection to abortion."

That is non-responsive to the issue here. The churches have a stricter prohibition on elective abortions than the religious employer who has already received an exemption, and whose exemption would thus not address the churches' particular religious objection. The churches can therefore rightly ask what lawful basis could support California's differential treatment of two sets of religious beliefs about abortion. This too required strict scrutiny, even as the churches did not need to allege such differential treatment for strict scrutiny to apply.

2019 (2017) (noting "that there is 'play in the joints' between what the Establishment Clause permits and the Free Exercise Clause compels") (quotations omitted); *Harris v. McRae*, 448 U.S. 297, 319–20 (1980). The Establishment Clause is not the right doctrinal box for the problem before us. The churches' briefs unsurprisingly devote limited attention to this claim.)

What I have yet to mention so far, of course, is *Fulton*. But that is because *Fulton* adds nothing new to the analysis. In *Fulton*, the Supreme Court considered Philadelphia's decision to stop referring children to a Catholic foster care agency because the agency, due to its religious beliefs about marriage, would not certify same-sex couples as foster parents. *See* 141 S. Ct. at 1874. One of the questions in *Fulton* was whether the Supreme Court should revisit *Employment Division v. Smith*. We therefore acted appropriately in staying this case pending *Fulton*, which could have substantially altered the Free Exercise Clause analysis.

But the Supreme Court in *Fulton* chose not to revisit *Smith*. Instead, it viewed Philadelphia's regime as unconstitutional under *Smith*'s individualized exemption exception. *Fulton* held that Philadelphia had not applied a neutral, generally applicable law under *Smith* because its foster care contract required agencies to not reject prospective foster parents based on their sexual orientation unless Philadelphia's Commissioner of the Department of Human Services granted the agency an "exception," which the Commissioner could do in her "sole discretion." *Fulton*, 141 S. Ct. at 1878. *Fulton*'s holding and analysis thus turns on *Smith*'s well-worn exception that "'where the State has in place a system of individual exemptions, it may not refuse to extend that system to cases of 'religious hardship' without compelling reason.'" *Id.* at 1877 (quoting *Smith*, 494 U.S. at 884). *Fulton* held that this exception applied because the "sole discretion" standard, "[l]ike [a] good cause provision," "incorporates a system of individual exemptions." *Id.* at 1878.

Although the Justices in *Fulton* disagreed as to whether the case presented an appropriate opportunity for

reconsidering *Smith*, they unanimously agreed that under existing law, strict scrutiny must apply because Philadelphia had created a system of individualized exemptions. The majority opinion located that exception to *Smith* in long-existing case law: *Smith* itself and *Sherbert v. Verner*. *See id.* at 1877. Justice Barrett in a three-Justice concurrence similarly explained that "[a] longstanding tenet of our free exercise jurisprudence—one that both pre-dates and survives *Smith*—is that a law burdening religious exercise must satisfy strict scrutiny if it gives government officials discretion to grant individualized exemptions." *Id.* at 1883 (Barrett, J., concurring). Justice Alito concurring in the judgment questioned whether this exception in fact pre-dated *Smith*. *Id.* at 1892 n.25 (Alito, J., concurring in the judgment). But Justice Alito (along with two more Justices) fully agreed that "*Smith*'s holding about categorical rules does not apply if a rule permits individualized exemptions." *Id.* at 1887. Indeed, California in its supplemental status report itself agrees that *Fulton* did not change preexisting precedent.

How the Supreme Court decided *Fulton*—as a fact-bound error-correction under existing law—means that merely vacating and remanding this case in light of *Fulton* is not a sound or equitable approach. It was clear before *Fulton* that California's understanding of the law, which the district court adopted, was manifestly incorrect. *Fulton* does nothing except confirm this.

Yet as noted, California in its supplemental status report suggests that it will remain for the district court to decide "which standard of review to apply following *Fulton*." Quite clearly, that is not an open question. And I would have held accordingly now. That would have set this case on a truer path that properly respected both the governing precedents

and the churches' significant interest in seeking appropriate relief under the Free Exercise Clause.