USING REVERSE VEIL PIERCING TO VINDICATE THE FREE EXERCISE RIGHTS OF INCORPORATED EMPLOYERS

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SEEMINGLY UNBEKNOWNST TO THE PRINCIPALS, a colloquy between U.S. District Court Judge Reggie Walton and U.S. Department of Justice lawyer Benjamin Berwick raised interesting questions about the potential intersection of corporate law and one of the most contentious issues in current constitutional law. The exchange took place during a motion hearing in *Tyndale House Publishers, Inc. v. Sebelius*,[1] in which the plaintiff is challenging the validity of a federal regulation requiring health-care plans to cover contraceptives and other reproductive-related services, which include sterilizations and abortion-inducing drugs, according to some critics of the mandate. Berwick argued that employers who chose to incorporate their business are precluded from raising First Amendment free exercise of religion-based objections to regulations affecting their business. In response, Judge Walton posed the following hypothetical:

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[1] Transcript of Motion Hearing, Tyndale House Publishers, Inc. v. Sebelius, No. CV 12-1635 (D.D.C. Nov. 9, 2012).

> [M]y wife has a medical practice. She has a corporation, but she's the sole owner and sole stock owner. If she had strongly-held religious belief and she made that known that she operated her medical practice from that perspective, could she be required to pay for these types of items if she felt that that was causing her to violate her religious beliefs?[2]

Berwick replied that the corporation and its shareholders are separate legal persons. The judge thereupon summarized his understanding of the government's position as being that his wife would "have to go as an individual proprietor with no corporation protection in order to assert her religious right."[3] Berwick did not contest that characterization.

Assume *arguendo* that Judge Walton's characterization is an accurate statement of the relevant law. To restate the hypothetical, a sole proprietor could raise a valid free-exercise-based challenge to the mandate, but otherwise identically situated businesspersons who had incorporated their company lose the ability to do so. It is at this point that the corporate law doctrine known as reverse veil piercing (RVP) comes into play. Under it, a court will disregard the corporation's separate legal personality.[4] Hence, if Judge Walton's wife were able to successfully invoke RVP, she and her corporation would no longer be separate legal persons and she would be able to assert her free-exercise claims.

Part I of this Article sets the background by briefly describing the relevant federal health insurance mandate. As we shall see, courts lack a coherent doctrinal framework for determining when the corporate form should be disregarded in mandate challenges. My thesis

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[2] *Id.* at 35.

[3] *Id.*

[4] *See* In re Friedlander Capital Management Corp., 411 B.R. 434, 441 n.2 (Bankr. S.D. Fla. 2009) (explaining that "insider reverse piercing . . . involves a controlling corporate insider seeking to disregard the corporation"). Presumably the health insurance mandate is simply a case study, as RVP would seem to apply in any situation in which incorporation causes businesspersons to lose the ability to assert any constitutional right. But that is a question beyond the scope of this article.

is that the law of veil piercing provides the analytical framework currently missing in these cases. Part II provides a capsule review of RVP law. Part III then explores how RVP should be applied in these cases.

I.
THE MANDATE

The Patient Protection and Affordable Care Act (ACA) and regulations promulgated thereunder require employers to provide health care plans to their employees that cover contraceptives and other reproductive services.[5] As originally promulgated, the mandate exempted a very narrowly defined category of religious employers, which excluded all for-profit entities and many non-profits as well.[6] The mandate proved highly controversial and the Obama administration received considerable legal and political push back from both non-profit religious organizations and for-profit businesses owned by people of faith with religious objections to the mandate.[7]

A. The Tyndale case

In the *Tyndale House Publishers* case before Judge Walton, for example, the plaintiff is a for-profit corporation that "publishes a wide array of Christian books ranging from Bible commentaries to books about family issues to Christian fiction."[8] Tyndale has 260 employees and provides them with a self-insured health care plan.

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[5] Pub. L. No. 111-148, 124 Stat. 119 (2010); 77 Fed. Reg. 8725 (Feb. 15, 2012). For sake of semantic simplicity, I will refer to this requirement herein as the "mandate."

[6] 45 C.F.R. § 147.130(a)(1)(iv)(B) (2010).

[7] Constitutional challenges to the Patient Protection and Affordable Care Act, en.wikipedia.org/w/index.php?title=Constitutional_challenges_to_the_Patient_Protection_and_Affordable_Care_Act&oldid=537576233 (last visited Feb. 28, 2013) ("Several dozen lawsuits have been filed challenging the Department of Health and Human Services' decision to mandate that health plans cover female contraception.").

[8] Tyndale House Publishers, Inc. v. Sebelius, 2012 WL 5817323 at *2 (D.D.C. 2012).

Voting control of Tyndale rests in the Tyndale Trust, which owns 84% of the company's voting stock.

> The same group of individuals serves both as the trustees of the Tyndale Trust and as the board of directors of Tyndale House Publishers, and each individual is "required to sign a Statement of Faith each year to show that they hold certain religious beliefs, which are typically described as evangelical Christian beliefs."[9]

The Tyndale House Foundation, a non-profit religious charity, owns a substantial amount of nonvoting stock, as a result of which it receives 96.5% of Tyndale's distributed profits.

Tyndale and its fellow plaintiffs challenged the mandate on a number of grounds, of which the most pertinent for present purposes are their claims under the free exercise clause of the First Amendment to the U.S. Constitution and the Religious Freedom Restoration Act (RFRA). Similar claims have been brought in 48 cases challenging the mandate, 18 of which involved for-profit employers.[10] As of March 2013, in 12 of the 18 for-profit cases courts have granted preliminary injunctions against the mandate while the cases go forward to trial, in 4 the court denied a preliminary injunction, and in 2 cases the court had not yet acted. None of the for-profit or non-profit employer cases had been decided on the merits as of that date.[11]

The substantive constitutional and statutory arguments relating to the mandate are outside the scope of this Article, as is any assessment of their legal merits. Instead, the pertinent question is

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[9] *Id.* at *3.

[10] *HHS Mandate Information Central*, THE BECKET FUND FOR RELIGIOUS LIBERTY, www.becketfund.org/hhsinformationcentral/ (last visited Mar. 1, 2013).

[11] *Id.* In *Tyndale*, Judge Walton declined to reach the First Amendment issue as he believed plaintiffs had "shown a likelihood of success on the merits of their RFRA claim" and had further concluded that the other factors of the preliminary injunction standard also pointed in the plaintiff's favor. *Tyndale*, 2012 WL 5817323 at *4 n.7. Accordingly, he granted the requested injunction "on the basis of that claim." *Id.*

whether incorporation affects an objecting employer's ability to challenge the mandate.

B. Would an unincorporated employer have standing to challenge the mandate?

None of the 18 cases brought against the mandate involve sole proprietors or other unincorporated employers. In *Tyndale*, Judge Walton followed earlier precedents involving free exercise claims against other laws holding that corporations have standing to assert their stockholders' free exercise claims. It therefore follows that if the owners had not incorporated their business they would have standing as individuals to assert those claims.[12]

C. Does incorporation affect an employer's standing to challenge the mandate?

A corporation is a legal person separate and distinct from its shareholders. Although the corporation as such has certain constitutional rights of its own, which it may bring suit to vindicate, courts have declined to resolve the "question of whether for-profit corporations can exercise religion within the meaning of the RFRA and the Free Exercise Clause."[13] Instead, as did Judge Walton in *Tyndale*, courts have asked whether a corporation has standing to assert its owner's free exercise rights.

In *Tyndale*, the government relied on the corporation's separate legal personhood to argue that a corporation could not have standing to vindicate the religious beliefs of its owners. In rejecting that argument, Judge Walton relied on *EEOC v. Townley Eng'g & Mfg. Co.*,[14] in which the defendant corporation claimed its free exercise

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[12] Charles A. Calleros, *Title VII and the First Amendment: Content-Neutral Regulation, Disparate Impact, and the 'Reasonable Person*,' 58 OHIO L.J. 1217, 1224 n.36 (1997) ("Of course, if an individual employer, such as a partner or sole proprietor, is held personally liable for his own harassing speech, he will have standing to assert his own First Amendment interests.").

[13] *Tyndale*, 2012 WL 5817323 at *5.

[14] 859 F.2d 610 (9th Cir.1988).

rights were violated by a provision of Title VII requiring employers to accommodate employees asserting religious objections to attending mandatory devotional services. The court declined to decide whether the corporation had free exercise rights, because the court determined that the corporation was an "extension of the beliefs" of its owners. Accordingly, the company had standing to assert the shareholders' personal free exercise rights. In so holding, however, the court identified no standard to be applied. To the contrary, its holding is best described as a statement of a conclusion rather than the result of an analytical process. Much the same could be said for the Ninth Circuit's subsequent decision in *Stormans, Inc. v. Selecky*,[15] upon which Judge Walton also relied, which again simply declared by fiat that:

> [T]he pharmacy was a "fourth-generation, family-owned business whose shareholders and directors [were] made up entirely of members of the Stormans family," and that "Kevin Storman's opposition to Plan B [was] that of [the pharmacy's] and all the owners." The court thus found that the pharmacy was "an extension of the beliefs of members of the Stormans family, and that the beliefs of the Stormans family [were] the beliefs of" the pharmacy. Because the pharmacy did "not present any free exercise rights of its own different from or greater than its owners' rights," the court held . . . that the company had "standing to assert the free exercise rights of its owners."[16]

Just as the Ninth Circuit thus failed to lay out a doctrinal standard by which to decide whether to disregard to corporate form, so too did Judge Walton. Instead, after reviewing the facts of the case at some length, he simply concluded that:

> Tyndale is a closely-held corporation owned by four entities united by their Christian faith, each of which plays a distinct role in achieving shared, religious objectives. Christian principles, prayer, and activities are pervasive at Tyndale,

[15] 586 F.3d 1109 (9th Cir.2009).

[16] *Tyndale*, 2012 WL 5817323 at *6 (citations omitted).

> and the company's ownership structure is designed to ensure that it never strays from its faith-oriented mission. . . . Tyndale's religious objection to providing insurance coverage for certain contraceptives reflects the beliefs of Tyndale's owners. Nor is there any dispute that Tyndale's primary owner, the Foundation, can "exercise religion" in its own right, given that it is a non-profit religious organization . . . . Accordingly, because Tyndale does "not present any free exercise rights of its own different from or greater than its owners' rights," it has "standing to assert the free exercise rights of its owners."[17]

In contrast, several other courts have declined to disregard the corporation form in this context. Instead, as the government argued in *Tyndale*, they have held that, in light of the corporation's separate legal personhood and "distinct legal entity," "the corporation is not the alter ego of its owners for the purposes of religious belief and exercise."[18] As one of these courts explained, the decision to incorporate one's business "brings obligations as well as benefits."[19]

D. Enter RVP

In sum, none of the cases – on either side of the issue – offered a coherent doctrinal justification for their holdings. In particular, they have almost uniformly ignored well-established principles of corporate law governing when the corporate veil may be pierced and the corporate form disregarded. To be sure, one court refusing to disregard the corporate form argued that "[i]t would be entirely inconsistent to allow [the individual plaintiffs] to enjoy the benefits of incorporation, while simultaneously piercing the corporate veil for the limited purpose to challenge these regulations."[20] In corporate law, however, courts regularly allow claimants to pierce the

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[17] *Id.* at 7 (citations and footnote omitted).

[18] Conestoga Wood Specialties, Inc. v. Sebelius, 2013 WL 140110, at *8 (E.D. Pa. Jan. 11, 2013).

[19] Autocam Corp. v. Sebelius, 2012 WL 6845677, at *7 (W.D. Mich. Dec. 24, 2012).

[20] *Conestoga Wood Specialties*, 2013 WL 140110, at *8.

corporate veil in both forward and reverse directions, while still affording the shareholders the other benefits of incorporation. When the veil is pierced going forward, shareholders are denied the benefit of incorporation, while avoiding some of the consequences of incorporation when the veil is reverse pierced. The argument thus is false.

II.
RVP

At least one court has recognized the potential for using RVP in the mandate cases, opining that these cases "pose difficult questions of first impression, including whether it is "possible to 'pierce the veil' and disregard the corporate form in this context," which merit "more deliberate investigation."[21] This article undertakes precisely that investigation. In order to do so, it must begin by summarizing the law of RVP.

A. Limited liability and veil piercing

Limited liability is a defining characteristic of the corporation. Model Business Corporation Act (MBCA) § 6.22(b) provides, for example, that "a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct." Despite this statutory shield, however, personal liability may be imposed on a shareholder under the equitable remedy known as "piercing the corporate veil" (PCV).[22] "The 'veil' of the 'corporate fiction,' or the 'artificial personality' of the corporation is 'pierced,' and the individual or corporate shareholder exposed to personal or

[21] Newland v. Sebelius, 881 F.Supp.2d 1287, 1296 (D. Colo. 2012).

[22] I. Maurice Wormser, *Piercing the Veil of Corporate Entity,* 12 COLUM. L. REV. 496, 517 (1912) ("When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime, the courts will draw aside the web [i.e., veil] of entity, will regard the corporate company as an association of live, up-and-doing, men and women shareholders, and will do justice between real persons.").

corporate liability, as the case may be, when a court determines that the debt in question is not really a debt of the corporation, but ought, in fairness, to be viewed as a debt of the individual or corporate shareholder or shareholders."[23]

B. RVP

Just as PCV allows a creditor to disregard the corporation's separate legal existence in order to treat the corporation as the shareholders' alter ego, RVP permits a shareholder to do so. In *Cargill, Inc. v. Hedge*,[24] for example, defendant Sam Hedge and his wife Annette had incorporated a 160-acre farm. Cargill sued Sam and the farm corporation for failing to pay for farm supplies purchased from Cargill. Cargill executed judgment on the farm, causing it to be sold. Annette Hedge was the sole stockholder of Hedge Farm, Inc., and intervened in the case to protect her interests.

Minnesota law exempts from execution "[t]he house owned and occupied by the debtor as his dwelling place, together with the land upon which it is situated," which in rural areas includes up to 80 acres.[25] Because the corporation was "an artificial entity needing no dwelling," the Hedges' incorporated farm was "not entitled to a homestead exemption."[26] Applying RVP, however, the court opted to disregard the Hedges' corporation and "treated the Hedge farm as

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[23] STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1.01 at 1-6 (1991 and supp.) (footnotes and emphasis omitted). I have elsewhere criticized PCV, arguing for its abolition. *See, e.g.,* Stephen M. Bainbridge, *Abolishing LLC Veil Piercing*, 2005 U. ILL. L. REV. 77; Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001). I have likewise been critical of RVP, arguing for its rejection. *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 166 (2002). Obviously, however, both PCV and RVP remain the law. The analysis herein is doctrinal rather than normative and therefore applies current law as given.

[24] 375 N.W.2d 477 (Minn. 1985). *See generally* Gregory S. Crespi, *The Reverse Pierce Doctrine: Applying Appropriate Standards*, 16 J. CORP. L. 33 (1990) (discussing RVP); Michael J. Gaertner, Note, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have it Both Ways?,* 30 WM. AND MARY L. REV. 667 (1989) (same).

[25] MINN. STAT. § 510.01-.02 (2012).

[26] *Cargill*, 375 N.W. at 478

if owned by Sam and Annette Hedge as vendees under their contract for deed."[27] Accordingly, they were "entitled to claim a homestead exemption in 80 acres of [the] farm . . . ."[28]

The *Cargill* court identified three factors to be considered in a RVP case. First, the court must examine "the degree of identity between the individual and his or her corporation [and] the extent to which the corporation is an alter ego" of the shareholder.[29] Second, the court must determine whether piercing the veil would injure third parties, such as creditors. Finally, are there "strong policy reasons" to justify a reverse pierce?

As to the first prong, the court held that:

> Here there is a close identity between the Hedges and their corporation. While the Hedges maintained some of the corporate formalities, such as keeping corporate minutes, filing corporate tax returns, and dealing with the Production Credit Association as a corporation, realistically, as the trial court found, they operated the farm as their own. They had no lease with the corporation and paid no rent. The farmhouse was their family home. Annette Hedge owned all the stock. Mr. and Mrs. Hedge and their daughters were the corporate directors with Sam Hedge as president, Patricia as vice-president, and Annette as secretary-treasurer. None of the officers received any salary.[30]

As to the second prong, the court acknowledged that Cargill would receive less money on its judgment, but concluded that "any unfairness in allowing [the Hedges] the homestead exemption is merely inherent in the exemption itself."[31] This argument, of course, is specious. Using RVP in this context significantly expands the scope of the exemption and thus serves as an independent source of potential unfairness.

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[27] *Id.* at 480.

[28] *Id.*

[29] *Id.* at 479.

[30] *Id.*

[31] *Id.*

The critical factor, however, seems to have been the third prong. RVP was justified so as to further "the purpose of the homestead exemption."[32]

> This state has long recognized the importance, notwithstanding the just demands of creditors, for a debtor's home to be a "sanctuary." This "wise and humane policy" is not just for the debtor's benefit, but is also "in the interest of the state, whose welfare and prosperity so largely depend upon the growth and cultivation among its citizens of feelings of personal independence, together with love of country and kindred – sentiments that find their deepest root and best nourishment where the home life is spent and enjoyed."[33]

III.
APPLYING RVP TO MANDATE CASES

Of the two versions of RVP, only so-called insider RVP (RVP-I) is at issue in mandate cases. The related doctrine known as outsider RVP (RVP-O) comes into play where a personal creditor of the shareholder seeks to disregard the corporation's separate legal existence.[34] Here, however, the shareholder is asking the court to disregard the corporation's separate legal personhood so as to allow the shareholder to vindicate his constitutional rights.

The difference between RVP-I and RVP-O has critical doctrinal implications. In particular, the first prong of the test used in both PCV and RVP-O focuses to a considerable extent on whether the shareholder complied with a long laundry list of corporate formalities.[35] When RVP-I is in play, however, those factors are largely irrelevant. "It would be clearly aberrant to allow a corporate insider to reverse pierce the corporate entity because the insider caused the entity to fail to observe the requisite corporate formalities and oper-

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[32] *Id.*

[33] *Id.* (citations omitted).

[34] *See generally* BAINBRIDGE, *supra* note 23, at 167-68 (discussing outsider RVP).

[35] *See id.* at 157-61. For a discussion of the tests used in PCV cases, see *id.* at 152-55.

ated it as the insider's alter ego."[36] In *State Bank in Eden Valley v. Euerle Farms, Inc.*,[37] for example, a Minnesota appellate court thus allowed the shareholders to reverse pierce even though significant corporate formalities had been observed because "there was a strong degree of identity between the Euerles and Euerle Farms."[38]

Analysis of the RVP-I cases thus suggests a three-pronged version of RVP that should be adopted in the mandate cases:

1. Is there such substantial identity of the shareholder(s)'s religious beliefs and the manner in which the corporation is operated and the purposes to which it is devoted that the corporation is effectively the shareholder's alter ego?
2. How strong is the government's interest in ensuring that the corporation's employees get the mandated insurance coverage?
3. Would reverse piercing this corporation's veil advance significant public policies?

As to the first prong, Judge Walton's analysis in *Tyndale* provides a useful model for future courts to follow.

- Veil piercing is a close corporation doctrine.[39] In this context, in particular, a public corporation with many shareholders holding diverse views is a poor candidate for RVP-I. In contrast, a closely held corporation – even if quite large by metrics such as assets or employees – with a small number of shareholders holding common religious beliefs is a good candidate.

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[36] Crespi, *supra* note 24, at 51.

[37] 441 N.W.2d 121 (Minn. App. 1989).

[38] *Id.* at 124.

[39] *See* Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities,* 32 WAKE FOREST L. REV. 1, 9 n.48 (1997) ("Piercing occurs only within corporate groups or in close corporations with fewer than 10 shareholders.").

- Do the corporation's articles of incorporation include a statement of purpose referencing religious beliefs and goals?
- Is the ownership structure of the corporation designed to ensure continuity of its religious purposes even after the original founders have retired or died?
- Are the directors and officers of the corporation obliged to share the founders' religious beliefs? If so, are they required to document that fact, such as by signing a statement of faith?
- Are religious practices such as devotions, prayer, scripture reading, or worship services routinely made a part of corporate meetings?
- Are such practices made available to employees?
- Is some substantial portion of the corporation's profits donated to religious charities or otherwise used to advance the founders' religious beliefs? The biblical concept of a tithe springs to mind here as a possible metric.

The more of these factors that a court finds to be present, the more willing the court should be to treat the corporation as the shareholder's alter ego.

Turning to the second prong, the government contends it has an interest in ensuring that Americans have access to the health insurance coverage required by the mandate.[40] Whether or not that interest rises to the level of a compelling one that would justify in-

[40] *See* Korte v. Sebelius, 2012 WL 6757353 (7th Cir. 2012) (noting that the government claimed "only a generalized interest in 'ensuring that employees and their families have access to recommended preventative health services,' and somewhat more specifically, 'ensur[ing] that decisions about whether to use contraception and which form to use are made by a woman and her doctor – not by her employer or insurer'").

fringing on free exercise and RFRA rights remains to be determined. In evaluating the government's interest, however, courts should note that the government has already undermined the mandate by carving out exemptions for grandfathered plans, employers with fewer than 50 employees, "member[s] of a recognized religious sect or division thereof" who have religious objections to the concept of health insurance, or religious employers [as defined in the regulations]."[41] As Judge Walton observed, a "law cannot be regarded as protecting an interest of the highest order . . . when it leaves appreciable damage to that supposedly vital interest unprohibited."[42]

As for the final prong, the government has tried to minimize the significance of the issues at stake by referring to the plaintiffs' interests rather than their rights. Conduct that is motivated by religious belief is accepted as one of the ways in which people exercise their religious freedom, however, even when the conduct occurs in a commercial setting.[43] As such, the strength of the public policy issues at stake in the mandate cases go far beyond the homestead policy at issue in the seminal Minnesota cases. The issues at stake here arise out of the First Amendment, not a mere statute.

The values protected by the religious freedom clauses of the First Amendment "have been zealously protected, sometimes even at the expense of other interests of admittedly high social importance."[44] Accordingly, "no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or *force citizens to confess by word or act their faith therein*."[45] Because that is precisely what the plaintiffs in the mandate cases claim the government is forcing them to do, the policy prong of the RVP-I standard strongly favors the plaintiffs.

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[41] *Tyndale*, 2012 WL 5817323 at *17 (citations omitted).

[42] *Id.* (*quoting* Church of the Lukumi Bablu Aye, Inc. v. City of Hialeah, 508 U.S. 520, 547 (1993)).

[43] Attorney Gen. v. Desilets, 636 N.E.2d 233, 237-38 (Mass. 1994).

[44] Wisconsin v. Yoder, 406 U.S. 205, 214 (1972).

[45] West Virginia Bd. of Ed. v. Barnette, 319 U.S. 624, 642 (1943) (emphasis supplied).

IV.
CONCLUSION

Invoking RVP-I in the mandate cases would not be outcome determinative. Instead, it would simply provide a coherent doctrinal framework for determining whether the corporation is so intertwined with the religious beliefs of its shareholders that the corporation should be allowed standing to bring the case. Whatever demerits RVP-I may have, surely it provides a better solution than the courts' current practice of deciding the issue by mere fiat.