

Victories for Plaintiffs in ERISA Church Plan Cases Cause Concern for Church-Affiliated Pension Plan Sponsors

Recent decisions by the federal courts of the Third, Seventh and Ninth Circuits have added fresh fuel to a brewing legal controversy about which retirement plans can qualify as “church plans” exempt from the Employee Retirement Income Security Act (“ERISA”). The proper interpretation is far from settled, with similar cases still pending and decades of contrary authority on the books. Nonetheless, if other courts follow the lead of these three circuit courts, church-affiliated pension plan sponsors could find themselves obligated to accelerate funding of their plans by millions of dollars.

The Church Plan Exemption

Generally, organizations that provide retirement plans for their employees must comply with certain standards under ERISA, including:

- Regularly providing plan participants with information regarding the plan’s features and funding;
- Meeting minimum standards for participation, vesting, benefit accrual and adequate funding; and
- Prudent operation of the plan by fiduciaries charged to act exclusively in the plan’s interest.

However, Congress carved out several exemptions to this general rule, including an exemption for retirement plans for churches and church-affiliated organizations, known as “church plans.” (The word “church” in this case is intended to apply to other religions’ houses of worship as well as Christian churches.) This exception has been of particular interest to churches and church affiliates with “defined benefit” pension plans, which promise employees a fixed amount of money upon retirement. The sponsor of an ERISA-governed defined benefit plan must make contributions as needed to keep the plan in compliance with minimum funding thresholds intended to protect the plan’s solvency, pay premiums to the Pension Benefit Guaranty Corporation to insure participants’ benefits, manage the plan in the best interest of plan participants and provide notices about benefits to its plan participants. In contrast, church plans are exempt from these requirements, and a number of church plans now face substantial funding shortfalls.

Over the last few years, and particularly in early 2016, plaintiffs’ lawyers have filed a series of lawsuits against a variety of church-affiliated plan sponsors with underfunded pension plans. The lawsuits challenge the plans’ status as church plans, and seek to have the courts require the plan sponsors to fund the plans in accordance with ERISA. The defendant plan sponsors have pointed to thirty years of district court decisions and IRS rulings in favor of their church plan status, but contrary decisions in recent district court cases and the new rulings from the Third, Seventh and Ninth Circuits have given new life to church plan challenges.

An Issue of Statutory Interpretation

The original text of ERISA’s church plan exemption states that a qualifying church plan must be “established and maintained . . . by a church or by a convention or association of churches.” However, Congress amended the church plan exemption in 1980 to provide that:

“A plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a

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civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.”

Church-affiliated organizations, such as hospitals and colleges, argue that the 1980 amendment expands the group of organizations that may establish a church plan, and allows them to sponsor ERISA-exempt church plans. For the last 30 years, the courts and the IRS have agreed. Now, however, some district courts and the three circuit courts to rule directly on the matter have agreed with the plaintiffs’ contention that only a church can establish a church plan, even if a church-affiliated organization can subsequently maintain the plan without causing the plan to lose church plan status.

The Cases

At the district court level, until December 2015, the challengers to and defenders of the church plan exemption were at an impasse. Three district courts had held that plans that are established and maintained by church-affiliated organizations qualify for the exemption, and three had ruled that only a church can establish a church plan. In December 2015 and March 2016, in *Kaplan v. Saint Peter’s Healthcare System* and *Stapleton v. Advocate Health Care Network*, the Third and Seventh Circuits (respectively) both ruled for the plaintiffs that the relevant plans were subject to ERISA. In July 2016, the Ninth Circuit agreed in *Rollins v. Dignity Health*. A case remains pending in one other circuit, with more working their way through the lower courts.

In *St. Peter’s*, *Stapleton* and *Rollins*, the plan sponsors argued that the 1980 amendment to the church plan exemption created an additional carve-out for plans that are maintained by a church-affiliated organization, even if the plan was not created by a church. They further argued that their position is supported by 30 years of precedent from the IRS and the courts. In contrast, the plaintiffs argued that the 1980 amendment merely allows for a subset of plans that can be maintained by a church-affiliated organization but still must be initially established by a church. In making this argument, the plaintiffs pointed to the language of the statute itself, and to the legislative history of the 1980 amendment. They noted, among other arguments in support of their view, that the final draft of the amendment deleted the language “established and maintained” from the clause regarding church-affiliated organizations, and replaced it with “maintained.”

The courts ultimately rejected all of the plan sponsors’ arguments, finding that the text of ERISA, as amended by the 1980 church plan amendment, was unambiguous. They explained that the church plan exemption outlines two requirements—that the plan be both established *and* maintained by a church. They then concluded that the 1980 amendment only allowed a church-affiliated organization to satisfy the second requirement and “maintain” (not establish) the plan. The Third Circuit remarked that a reading of the statute using the plan sponsors’ argument would mean that any entity could establish a plan and have a church-affiliated organization maintain it, and thereby qualify as a church plan. This, the court concluded, would “nullify” ERISA’s “careful limitation.” The courts also agreed with the plaintiffs that the legislative history supported their interpretation of the statute. Furthermore, both the Third and Seventh Circuits noted that ERISA is a remedial statute intended to protect workers’ pensions, and that it should be “liberally construed” in favor of the beneficiaries of a plan.

Separately, the courts rejected defendants’ argument that the courts should defer to the IRS private letter rulings that have consistently supported the plan sponsors’ position. Such deference, the courts concluded, was not required, since these rulings are an informal method of providing guidance, do not have precedential authority, and conflicted (in the courts’ view) with the plain language of the statute. The courts were not persuaded that Congress’ failure to take action to reverse the IRS’ interpretation reflected Congress’ agreement with the IRS’ view, saying that there was no evidence that Congress had considered the issue. Finally, the courts rejected the defendants’ argument that plaintiffs’ interpretation of the statute would violate the Free Exercise clause of the U.S. Constitution.

Having concluded that the plain text of the statute, with further support from the legislative history, did not entitle the defendant sponsors’ plans to church plan status, the courts did not need to address the



plaintiffs' other arguments. Accordingly, the courts did not decide whether the church plan exemption itself is a violation of the Establishment Clause of the First Amendment, or whether the entities involved in the cases were sufficiently connected to a church to qualify for the exemption.

Implications for Current Church Plans

At present, three circuits have ruled in favor of the plaintiffs, and one other circuit has a case pending. Other cases are in progress in the district courts. If an appellate court reaches a decision contrary to those of the Third, Seventh and Ninth Circuits, the church plan controversy may become one that only Congress or the Supreme Court can resolve. The defendant plan sponsors in the *St. Peter's* and *Stapleton* cases have already requested Supreme Court review. If the Supreme Court rules against the defendants, or if the Court declines to review these cases and future appellate court decisions continue to favor the plaintiffs, church plan sponsors should consider revisiting their eligibility for the exemption unless Congress takes action. Because of the uncertainty created by the circuit courts' decisions, you should proceed with caution if you are operating or considering the acquisition of a church-affiliated entity that is relying on the church plan exemption. The impact of these cases could force many church-affiliated organizations to face the multimillion-dollar cost of bringing their plans into compliance with ERISA.

In addition, regardless of the outcome of the ERISA-based lawsuits, churches and church-affiliated organizations need to understand the potential liability associated with their retirement plans and consider the potential consequences of underfunding the plans. If ERISA does not apply, employees and retirees may have claims under state law if underfunding deprives them of benefits. Organizations also should consider the negative effect of adverse publicity, and the adverse impact on the morale of current employees, if retirees lose their pensions.

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