Arkansas Association of Defense Counsel

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The ERISA Church Plan Exemption - Debate over "And" and "Or" Continues

[Part 2 of 2]

The history of the church plan cases demonstrates that litigation, similar to politics, makes strange bedfellows. Plaintiffs' counsel have been on both sides of the issue, depending on the nature of the plan and the issues to be litigated. ERISA, when appropriately so, applies to both pension plans and welfare benefit plans, traditionally long-term disability plans. For the plan participant who wants to litigate the denial of his or her disability claim, ERISA presents well-established legal obstacles: preemption of state law remedies; limited discovery; no jury trial; possible discretionary review. The plan participant employed by a religiously affiliated organization thus argues for the application of the church plan exemption. He or she argues that he or she was employed by a church, and the claim is governed by state law.

The pension plan litigant has different motivations. ERISA has strict funding and disclosure requirements. For example, ERISA has requirements favoring the plan participant for the time period required to vest for accrued benefits. It has strict requirements for funds held in trust. An ERISA plan must be funded at certain levels, and it must provide notice to plan members of the funding, vesting, and procedural safeguards of ERISA. A plan that does not comply with these requirements is a prime target for an enterprising class action plaintiff's counsel. In these cases, the disgruntled pension participant sues the plan, likely asserts class action status, and argues that the plan is governed by ERISA and beyond the reach of the church plan exemption.

The Third Circuit was the first of the federal appellate courts to address the issue. *Kaplan v. St. Peter's Healthcare Sys.*, 810 F.3d 175 (3d Cir. 2015). The plaintiffs in that case challenged the asserted church plan status of a plan of St. Peter's Healthcare System, a nonprofit corporation that operated numerous facilities, including a hospital, and employed over 2,800 people. St. Peter's was connected to a Roman Catholic diocese in New Jersey. The bishop of the diocese appointed a majority of the board and retained veto authority over board decisions. Although not decided by the court, it is this author's opinion that St. Peter's was "controlled by or associated with" a church. This has been the trend of the courts with respect to Catholic-related hospitals, based on the hierarchical structure, and the control exerted by the Catholic Church.

St. Peter's, not the church, established a non-contributory, defined benefit plan. For over 30 years St. Peter's operated the plan in accordance with ERISA, informing plan members of ERISA rights. However, in 2006, St. Peter's applied to the Internal Revenue Service (IRS) for an ERISA exemption for the plan. While the application was pending, a plan participant filed a putative class action contending that the plan did not comply with ERISA, including an allegation that the plan was underfunded by more than $70 million. After the lawsuit was filed, the IRS issued a letter that the plan was an exempt church plan for tax purposes. St. Peter's filed a motion to dismiss, asserting its church plan status. The district court denied the motion. *Kaplan v. St. Peter's Healthcare Sys.*, 2014 U.S. Dist. Lexis 66092 (D. N.J. May 14, 2014). The Third Circuit heard the case on an interlocutory appeal. St. Peter's argued that after the 1980 amendment took effect, ERISA no longer required that a church establish the plan, as long as it was maintained by a church-affiliated organization. In affirming, the Third Circuit rejected this interpretation, concluding that the plain meaning of the statute retained the church establishment requirement.

The opinion is noteworthy for the hypothetical posed by the court in oral argument, and its reliance on defense counsel's response.

> St. Peter's responds by arguing that the language of § 3(33)(C)(i), which says that a plan "established and maintained" by a church "includes" a plan "maintained" by a qualifying church agency, means that any plan maintained, even if not established, by such an agency is exempt. This would be persuasive if there were only one requirement—maintenance—for an exemption. But here we have two requirements—establishment and maintenance—and only the latter is expanded by the use of "includes."
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> Indeed, St. Peter's essentially conceded the problem with its reading at oral argument when presented with the following scenario: Congress passes a law that any person who is disabled and a veteran is entitled to free insurance. In the ensuing years, there is a question about whether people who served in the National Guard are veterans for purposes of the statute. To clarify, Congress passes an amendment saying that, for purposes of the provision, "a person who is disabled and a veteran includes a person who served in the National Guard." Asked if a person who served in the National Guard but is not disabled qualifies to collect free insurance, St. Peter's responded that such a person does not because only the second of the two conditions was satisfied. This correct response only serves to highlight the fatal flaw in the construction of ERISA advanced by St. Peter's.

Kaplan v. St. Peter's Healthcare Sys., 810 F.3d 175, 181 (3d Cir. 2015).

The Seventh Circuit followed the reasoning of Kaplan in *Stapleton v. Advocate Health Care Network*, 2016 U.S. App. Lexis 4908 (7th Cir. Mar. 17, 2016). The plaintiffs in that case challenged the church plan exemption status of the pension plan of Advocate Health Care, a 501(c)(3) corporation formed in 1995 from a merger of two religiously associated health-care companies. After the merger, Advocate maintained its affiliation with both the Metropolitan Chicago Synod of the Lutheran Evangelical Church in America and the Illinois Conference of the United Church of Christ. Although not owned or funded by either entity, Advocate had contractual relations with both and affirmed that it followed certain core ministry principles. There was no denominational requirement for either employees or patients. Advocate's predecessor entity, also not a church, created ("established") a non-contributory, defined benefit pension plan. After Advocate's formation, it inherited the maintenance of the plan. Advocate funded the plan, and it had the authority to modify, amend, or terminate. Advocate admittedly did not follow the funding requirements of ERISA, claiming church plan status.

The plaintiffs sought a declaration that the plan was not a church plan, that the plan was governed by ERISA, or alternatively that the church plan exemption was unconstitutional. They also sought a mandatory injunction requiring Advocate to follow ERISA requirements, an award of penalties under ERISA, and damages. The district court ruled for the plaintiffs, finding that the Advocate plan was not a church plan. The Seventh Circuit affirmed and focused on the root of the confusion that the 1980 amendment has generated, the statutory language that "a plan established and maintained for its employees . . . *includes a plan maintained by an organization* . . . if such organization is controlled by or associated with a church or a convention or association of churches." Advocate argued that the language modified both "established" and "maintained," so that a plan established and maintained by a church included a plan that was only maintained by a church-affiliated organization.

The Seventh Circuit based its decision on established principals of statutory construction. While it analyzed the legislative history, this dicta was not the basis of the decision. The court ruled that the plain language of the statute required both establishment and maintenance by a church, and that only the maintenance requirement was modified by the 1980 amendment:

> Advocate's position—that a plan qualifies as a church plan merely by being maintained by a church-affiliated organization—has a fatal flaw. If a plan could qualify solely on the basis of being

maintained by a church-affiliated organization, the "established by a church" requirement of subsection (33)(A) would become meaningless. And we know that this is not so, for subsection (33)(A) is a separate, independent requirement of the statute. Advocate's reading, therefore, violates a cardinal rule of statutory interpretation that every word and clause must be given meaning. "It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" *Doe v. Chao*, 540 U.S. 614, 630-31, 124 S. Ct. 1204, 157 L. Ed. 2d 1122 (2004); see also *Kaplan*, 810 F.3d at 181 ("If [the hospital] were right, the church establishment requirement in § (33)(A) would be superfluous . . . a result we attempt to avoid when construing a statute). Thus the plain language of (33)(C) merely adds an alternative meaning to one of subsection (33)(A)'s two elements— "maintain" element—but does not change the fact that a plan must still be established by a church. *Kaplan*, 810 F.3d at 180. (The term "includes" merely provides an alternative to the maintenance requirement but does not eliminate the establishment requirement.); *Rollins*, 19 F. Supp. 3d at 914 ("if all that is required for a plan to qualify as a church plan is that it meet subsection C's requirement that it be maintained by a church-associated organization, then there would be no purpose for subsection A, which defines a church plan as one established and maintained by a church.").

Stapleton v. Advocate Health Care Network, 2016 U.S. App. Lexis 4908, at *14–16 (7th Cir. Mar. 17, 2016).

Several federal district courts have rejected the statutory interpretation of *Kaplan and Stapleton*. In the view of these courts, the 1980 amendment changed the essential requirements for church plan status. The modifications, according to these courts, expressed Congress's will to extend church plan status to plans administered by religiously affiliated agencies, regardless of whether the church had established the plan. *Lann v. Trinity Health Corp.*, 2015 U.S. Dist. Lexis 147205 (D. Md. Feb. 23, 2015); *Medina v. Catholic Health Initiatives*, 2014 U.S. Dist. Lexis 119491, 2014 WL 4244012, at *2 (D. Colo. Aug. 26, 2014); *Overall v. Ascension*, 23 F. Supp. 3d 816, 829 (E.D. Mich. 2014).

The district court in *Medina*, rejecting a magistrate's recommended disposition, which followed the rationale of *Kaplan and Stapleton*, analyzed that the 1980 amendment modified both the establishment and maintenance requirements. The court concluded that establish and maintain were not two distinct elements in the amendment, but "rather a singular element, a term of art." The court reasoned that the two elements cannot be analyzed separately:

> Indeed, it is not clear what establishment might mean without the additional requirement of maintenance. If the two requirements are thus divorced, churches would be required to devise and develop their own employee benefit plans themselves, rather than relying on a third party administrator. This cannot have been Congress's intent, and such a conclusion is neither required nor supported by the language of the statute.

Medina v. Catholic Health Initiatives, 2014 U.S. Dist. Lexis 119491, at *6–7 (D. Colo. Aug. 26, 2014). The district court in *Overall* ruled that because Congress in 1980 repeated the language "established and maintained by a church," which was included in the original definition, the amendment's reference that such plans "includes plans" established and maintained by churches meant that Congress expanded the definition.

It is likely that these cases are not the end of the church plan debate. This author predicts that one or more circuits will adopt the competing view. Indeed, it is arguable that the Fourth Circuit in *Lown* endorsed that statutory interpretation. Perhaps in the near future, the Supreme Court will decide what Congress meant. Until then, the ERISA bar and the federal courts will continue to offer their own interpretations.

Addendum

This article was authored in May 2016 and published in the August 2016 issue of "For the

Defense." Since publication, the Ninth Circuit weighed in on this issue. Following the reasoning of Kaplan and Stapleton, the court ruled that a pension plan which was not established by a church could not qualify for the church plan exemption. Rollins v. Dignity Health, 830 F.3d 900 (9th Cir. 2016). The U.S. Supreme Court granted cert. on December 2, 2016 to review Rollins, Stapleton, and Kaplan. The Court stated the question presented:

"The question presented is whether the church plan exemption applies so long as a pension plan is maintained by an otherwise qualifying church- affiliated organization, or whether the exemption applies only if, in addition, a church initially established the plan."

So, the debate over "and" or "or" will be resolved by the Supreme Court sometime soon. Stay tuned.

The AADC thanks David M. Donovan of Watts, Donovan & Tilley for writing this article.

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