LEGAL

Courts Redefine ERISA's Church Plan Exemption

The recent burst of litigation over ERISA's exemption for church plans has amplified the confusion and the uncertainty over when it should apply. What's next?

BY STEPHEN ROSENBERG

One of my earliest clients first began working with ERISA-governed plans in 1975, shortly after the statute was enacted. He would often tell how, back then, with little if any law to guide them, he and his colleagues would essentially make it up as they went along.

This always struck me as little more than a humorous memory until recently, when plaintiffs' lawyers began suing large medical institutions affiliated with religious entities for the purpose of attacking the status of their benefit plans under ERISA's exemption for church plans. The lawsuits assert that these plans are not properly within that exemption, and therefore must be brought into compliance with ERISA. Suddenly, my client's long-ago stories about interpreting ERISA without much legal guidance had new resonance because, in many ways, the history of whether plans qualify for the church plan exemption is not much different. There was, until very recently, little modern case law on the issue, and the exemption was often claimed so long as the benefit plan looked affiliated, even if indirectly, with a religious body.

The statutory language itself, however, isn't clear as to when the exemption should apply, and the recent burst of litigation over the question has not clarified that issue. If anything, the current state of case law on the issue, dominated by a pair of recent court rulings, has simply amplified the confusion and the uncertainty, by staking out two diametrically opposed positions on the issue. Without writing a tax treatise, the issue, in layman's terms, boils down essentially to the question of whether a benefit plan, to fall within the exemption and thus outside the scope of

ERISA, must be directly established by a religious entity or whether it is enough if the benefit plan is established by an organization — such as a medical institution — that was in turn established by a religious entity.

For many years, the latter interpretation seemed to rule, and invoking the church plan exemption from ERISA's strictures on this basis was not generally challenged by participants or otherwise in the courts. To some extent, this may have been due to the fact that IRS private letter rulings appeared to bless a broad reading of the exemption. As one federal court recently explained, "the IRS recognized … that the "church plan" exemption … includes plans sponsored by non-profit organizations that are controlled by or associated with a church," and not just plans directly established by a church. (*Overall v. Ascension,* 2014 WL 2448492 (E.D.Mich. May 13, 2014). As that court noted, the "IRS has followed this rule for more than 30 years."

The plaintiffs' class action bar, though, recently took first notice and then aim at some of the large plans, primarily affiliated with large medical institutions, that had laid claim to church plan exemptions and thereby avoided complying with all of the dictates of ERISA. The plans' first line of defense was to fall back on the fact that the IRS, through private letter rulings, had approved of the use of the exemption, but lawyers for plaintiffs had a retort ready to provide to courts: namely, that it is the responsibility of federal judges to decide this issue, not that of IRS examiners.

The courts, recognizing this fact, then proceeded to come to inconsistent conclusions with regard to the exemption, even while acknowledging that they needed to reach an independent conclusion rather than simply adopt that of the IRS. At least one court, in a thorough analysis of the issue, has concluded that the broad interpretation of the exemption should continue, and that the benefit plan of a large, multistate health care entity does not have to comply with ERISA because it falls within the church plan exemption, even though only the parent entity, and not the plan itself, was established by a church. A small sampling of other courts has now gone the other way, finding that a benefit plan can only fall within the exemption, and therefore not have to comply with ERISA, if the plan itself was established by a church or similar religious entity.

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There is no clear answer to the question of which of these courts is correct, because the language of the statute is not crystal clear. One can reasonably interpret the language in either direction, and we will only have an answer, barring congressional amendment of the statute (seemingly unlikely, but if the suits targeting the exemption rattle the cages of enough large plan sponsors, it is certainly not out of the question), when the courts finally coalesce around a particular interpretation and application of the exemption.

This is likely to happen in one of two ways, the first of which is that a majority of the courts to consider the issue will reach the same conclusion, creating a body of law persuasive enough to convince courts to follow that rule whenever the exemption is at issue. The second one will only occur if the first doesn't, which is that eventually the U.S. Supreme Court will have no choice but to weigh in and establish a rule on the issue if the lower courts do not come to a consensus on the issue. If enough courts split in different directions over such an important issue to plan operation, it will only be a matter of time before one of those decisions is accepted for review by the Supreme Court.

However, this doesn't answer the question of what the rule should be, and how broadly courts should apply the exemption while creating the initial, modern era body of law on it that will either lead to a consensus view of the exemption or eventually to review by the Supreme Court. To answer this, one has to look at the original purpose of ERISA, which was to protect employee benefits while encouraging employers to create benefit plans. With that thought in mind, we can watch the current crop of lawsuits over church plan exemptions, and, once the evidence comes to light in those cases, ask whether the employees were receiving better benefits and protections than they would have been if subject to ERISA, or instead the opposite.

Given ERISA's original purpose, the reading that should be given to the exemption is the one that results in better benefits and superior protections for the employees. If the evidence shows that participants in these plans have been better off without ERISA's application, then the exemption should be given its broader, historical reading, but if not, then the courts who are now applying a narrower reading of the exemption will be the ones on the right track. PC

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