

California District Court Denies “Church Plan” ERISA Exemption to Pension Plan of Church-Affiliated Non-Profit Healthcare System, Creating Conflict on Requirements for “Church Plan” Exemption

The District Court for the Northern District of California recently held in a putative class action that the defined benefit pension plan of a church-affiliated non-profit healthcare system, Dignity Health (“Dignity”), was not a “church plan” as defined in the Employee Retirement Income Security Act of 1974 (“ERISA”), 29 U.S.C. § 1002(33), and therefore was not exempt from ERISA. Rollins v. Dignity Health, Case No. 13-1450 (N.D. Cal. Dec. 12, 2013). The Rollins decision conflicts with thirty years of private letter rulings issued by the Internal Revenue Service (the “IRS”) and several prior decisions in other jurisdictions, which have held that pension plans of church-affiliated non-profit organizations may be church plans exempt from ERISA if the non-profits are controlled by or associated with a church. The potential impact of the Rollins decision is significant for both non-profit organizations that currently maintain church plans and potential acquirers of these organizations.

Decision

In Rollins, the plaintiff, a participant in Dignity’s pension plan, sued Dignity for a determination that the plan was not a church plan exempt from ERISA and an injunction to compel Dignity to comply with ERISA’s requirements. The plaintiff also sought penalties for Dignity’s failure to comply with ERISA and to disgorge profits resulting from alleged ERISA fiduciary breaches. Dignity moved to dismiss the complaint on the grounds that the plan is a church plan and thus exempt from ERISA as a matter of law. The Court, in its decision, denied Dignity’s motion to dismiss and held that the plan did not meet the statutory requirements to be a church plan exempt from ERISA.

The Court interpreted ERISA’s definition of “church plan” to require that a church or a convention or association of churches establish the plan at issue. Dignity conceded that its plan had not been established by a church or convention or association of churches, but argued the plan satisfied the statute’s requirements because the plan was maintained by an organization “controlled by or associated with a church” (in Dignity’s case, the Roman Catholic Church). Dignity’s position is consistent with a series of IRS private letter rulings dating back to the 1980s and several prior cases. The Court acknowledged these prior letter rulings and decisions, but rejected their reasoning in favor of a different interpretation of the statute. Since Dignity conceded its plan had not been established by a church, and the Court determined this was required to be a church plan, the Court ruled that Dignity’s plan was not a church plan exempt from ERISA.

Potential Implications for Church Plan Sponsors

The Rollins decision creates uncertainty regarding a pension plan’s status as a church plan, because some plans currently believed to be church plans may not satisfy the Rollins requirement that they have been “established” by a church or by a convention or association of churches. Many church-affiliated non-profit organizations maintain retirement plans that do not comply with ERISA’s requirements on the grounds that they are exempt. If the Rollins standard were adopted and applied by more courts, other plans currently believed to be exempt church plans could be found to actually be subject to ERISA and all its requirements.

Imposing ERISA’s requirements on a plan thought to be exempt from ERISA could have immediate and significant results. Because they are exempt from ERISA, church plans need not comply with, among other things, ERISA’s reporting and disclosure requirements, participation and vesting rules, and fiduciary and

prohibited transaction requirements. Most significantly, church plans that are defined benefit pension plans are exempt from ERISA's minimum funding standards and are not required to pay PBGC insurance premiums. Requiring these plans to comply with ERISA's minimum funding and PBGC insurance requirements could impose substantial contribution requirements on the plan sponsor, particularly for underfunded pension plans where "catch-up" contributions may be required. Further, significant fees and penalties for failure to comply with ERISA's requirements in the past could potentially apply, as is alleged in Rollins against Dignity.

Several other suits have been filed in the past year alleging that church-affiliated non-profit pension plans are not church plans under ERISA, making virtually identical arguments to those in the Rollins case. The decision in Rollins may lead to further suits of this kind by church plan participants seeking to impose ERISA's requirements on pension plans maintained by church-affiliated non-profit organizations.

Potential Implications for Buyers of Non-Profit Entities

The Rollins decision also creates uncertainty in the context of mergers and acquisitions where the target entity is a non-profit organization that maintains what it believes to be a church plan exempt from ERISA. Potential purchasers of, or entities seeking to become affiliated with, non-profit entities that sponsor church plans should be aware of the potential liability and implications if the target's church plan were later found to be subject to ERISA and all of its requirements.

If a plan believed to be a church plan is found to be subject to ERISA, one major implication is that affiliates of the plan sponsor, including a buyer following a transaction, may be liable for the plan's obligations. Under ERISA, liability for a pension plan can extend to the sponsor's ERISA "controlled group," a broadly-defined concept that can attach liability to affiliates not directly participating in the plan. Another implication, noted above, is that the funding obligations for a defined benefit plan, particularly an underfunded plan, may be substantially greater if the plan is subject to ERISA, imposing unexpected financial burdens on the target.

Given the uncertainty created by Rollins regarding which plans qualify as church plans, buyers should be cautious when assessing and structuring transactions involving a target that sponsors a church plan.

Current Status of Rollins Decision

Dignity may seek an immediate appeal of the Rollins decision on an interlocutory basis. If permitted, the appeal would be heard by the Court of Appeals for the Ninth Circuit, whose jurisdiction covers California, Arizona, Nevada, Idaho, Montana, Oregon, Washington, Alaska, and Hawaii. If an interlocutory appeal is not permitted, Dignity will be required to wait until the end of the case before it can seek an appeal of this ruling.