CHURCH-AFFILIATED ORGANIZATIONS FACE NEW CHALLENGES AFTER *ADVOCATE*

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The law as it stands after *Advocate* leaves open questions.

In its May/June 2017 issue, *Exempts* addressed the pending Supreme Court review of *Advocate Healthcare Network v. Stapleton.*[1] On 6/5/17, the Supreme Court completed that task.[2] It held 8-0 that the Employee Retirement Income Security Act (ERISA) provides an exemption for an employee benefit plan[3] maintained by a church-affiliated organization[4] regardless of whether a church-affiliated organization also established the plan.[5] In reaching this conclusion, *Advocate* resolved a long-standing question of statutory interpretation under ERISA in favor of plans maintained but not established by church-affiliated organizations.

While this represents a clear victory for such church-affiliated organizations on the question before the Court, it is important to understand that *Advocate* nonetheless leaves significant unaddressed areas that require resolution in order to clarify the scope and application of the church plan exemption. First, how do church-affiliated organizations that satisfy the "maintained" criterion for the church plan exemption determine whether they also satisfy the other statutory requirements for exemption, and is the exemption itself even permissible under the Establishment Clause of the First Amendment?[6] Second, if the church plan exemption does apply, what legal obligations does a non-ERISA plan face in lieu of the standards applicable to an ERISA plan?

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Requirements for exemption

ERISA provides that plans maintained by church-affiliated organizations must satisfy specific statutory requirements in order to claim the church plan exemption:

> A plan established and maintained … by a church … includes a plan maintained by an organization, whether a civil law corporation or otherwise, *the principal purpose or function of which is the administration or funding of a plan* … for the employees of a church … if such organization is *controlled by or associated with a church.*"[7]

The authors refer to these as the "principal purpose" and "control or association" requirements. As discussed below, because the existing legal authority does not fully address or define either requirement, further litigation addressing the scope of the ERISA exemption for plans maintained by church-affiliated organizations is likely, including arguments concerning its constitutionality, as well as those specific to the statutory text.

Principal purpose. What must an organization do or not do in order to have the principal purpose of

administering or funding a plan? No court appears to have addressed this question. In the absence of generally binding legal authority, IRS private letter rulings represent the best available source of guidance. (Letter rulings clarify the IRS stance on a specific set of facts; they are explicitly nonbinding on other parties and may not be cited as precedent.[8]) Prior to *Advocate*, hundreds of church-affiliated organizations had requested letter rulings in order to determine whether their plans qualified for the church plan exemption and corresponding tax treatment under the Code.[9]

As part of issuing letter rulings to these organizations, the IRS had to determine whether they satisfied the principal purpose requirement.[10] Existing rulings indicate both some breadth and some limitations in the IRS application of this requirement. On the one hand, the IRS appears to accept that an organization may set up an internal benefits committee to administer a plan rather than having to create a separate corporation for such purpose. In a 2015 ruling, it stated:

> [T]he administrative control of the Plans is vested in the Committee and the Committee's principal purpose and function is the administration of the Plans.... Thus, the administration of the Plans satisfies the requirements regarding church plan administration ... we conclude that the Plans are church plans as defined.[11]

On the other hand, other letter rulings suggest that certain plan structures could preclude claiming the church plan exemption. A 2013 ruling held that a plan did not qualify for the exemption because "Plan X was a multiple employer plan, not all of whose participating employers were church plans [*sic*] when established ... therefore we find that neither Plan X nor Plan Y as a continuation of Plan X, is or can become a church plan."[12]

Regardless of the breadth or limitations on the church plan exemption suggested by such rulings, their non-precedential status means that court deference to their legal conclusions cannot be assumed. The Seventh, Third, and Ninth Circuits emphasized this absence of required deference when the church-affiliated organizations in the cases that were ultimately consolidated in *Advocate* cited numerous letter rulings.[13] The Seventh Circuit's response is illustrative:

> It is tempting indeed to turn to the [IRS] interpretation ... but we can do so only when the opinions of that agency are expressed after a formal adjudication or notice and comment rulemaking ... the fact that the IRS private letter rulings have been 'long standing' and abundant does not alter our conclusion."[14]

Although Justice Anthony Kennedy did ask during oral arguments in *Advocate* about the "hundreds of IRS letters approving [the exemption],"[15] the Court's ruling did not address the existence of the letter rulings, much less the weight to be accorded to the legal conclusions therein. Thus, the letter rulings addressing the principal purpose requirement, while offering some insight into IRS reasoning under specific fact patterns, do not offer authoritative reliance to church-affiliated organizations seeking clarity about the status of their organizational structures.

Control or association. What level of connection qualifies for an organization to be controlled by or associated with a church? The text of ERISA provides only that "[A]n organization ... is associated with a church ... if it shares common religious bonds and convictions with that church."[16] It does not elaborate on what constitutes control, or common bonds and convictions.

Court decisions provide some further guidance on these questions. In *Lown v. Continental Casualty Company*,[17] an employee of Baptist Health System of South Carolina asserted that litigation of her claim under the System's long-term disability plan was not subject to federal question jurisdiction because the

Advocate resolved a long-standing question of statutory interpretation in favor of plans maintained but not established by church-affiliated organizations.

1 McKenna and Keane, "Affiliated Organizations Seek Relief on ERISA Church Plan Exemption," 28 Exempts 6, page 3 (May/June 2017).

2 *Advocate Health Care Network v. Stapleton*, 581 U.S. ___, 137 S. Ct. 1652 (2017). Justice Neil Gorsuch did not take part in the consideration or decision of the cases consolidated in *Advocate*.

3 The benefit plans at issue in *Advocate* were pension plans. Nonetheless, the definition of a church plan for purposes of ERISA applies to all employee benefit plans, including health and welfare as well as pension plans, and the decision in *Advocate* correspondingly encompasses all employee benefit plans. *See* 29 U.S.C. section 1003(b)(2).

4 The terms "church-affiliated organization" and "church affiliate" do not appear in the text of ERISA. However, they are used in *Advocate* by both the plaintiff healthcare networks and the Court. Precisely because they do not reference a specific statutory provision, the terms provide a useful shorthand to describe entities that are not churches themselves, but that have some level of affiliation or association with a church. For consistency, the term "church-affiliated organization" is used throughout this article.

5 *Advocate*, 137 S. Ct. at 1652, 1655-57.

6 Writing for the court, Justice Elena Kagan acknowledged this point in a footnote, stating, "The employees alternatively argued in the District Court that the hospitals' pension plans are not 'church plans' because the hospitals do not have the needed association with the church and because, even if they do, their internal benefits committees do not count as principal-purpose organizations." *Advocate, supra* note 2 at 137 S. Ct. 1657, fn. 2.

7 29 U.S.C. section 1002(33)(C)(i) (emphasis added).

8 Internal Revenue Code Section 6110(k)(3).

9 *Advocate, supra* note 2 at 137 S. Ct. 1657.

10 Ltr. Rul. 201505050.

11 *Id.*

12 Ltr. Rul. 201323042.

13 *Rollins v. Dignity Health*, 830 F.3d 900 (CA-9, 2016); *Stapleton v. Advocate Health Care Network*, 817 F.3d 517 (CA-7, 2015); *Kaplan v. St. Peter's Healthcare System*, 810 F.3d 175 (CA-3, 2015).

14 *Stapleton, supra* note 13 at 817 F.3d 530.

15 Transcript of Oral Argument at 33, *Advocate*.

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System's ties to the South Carolina Baptist Convention exempted the plan from ERISA. In ruling that the exemption did not apply to the System's plan, the Fourth Circuit stated that the South Carolina Baptist Convention did not control the System because it did not appoint or approve any System board members and did not provide any monetary support to the System.[18] The Court also stated that, in deciding whether an organization shares common bonds and convictions with a church, three factors bear primary consideration: (1) whether the religious institution plays any official role in the governance of the organization, (2) whether the organization receives assistance from the religious institution, and (3) whether a denominational requirement exists for any employee or patient/customer of the organization.

Although the Eighth Circuit applied this nonexclusive three-part test in *Chronister v. Baptist Health* to reach the conclusion that another long-term disability plan sponsored by a not-for-profit health system was subject to ERISA, [19]the test may raise as many questions as it resolves when applied to the specific factual circumstances of a church-affiliated organization. The structure of Dignity Health, a major California healthcare system, is instructive in this regard. The non-profit hospital network formally ended ties with the Catholic Church in 2012.[20] However, multiple religious orders, including the Sisters of Mercy of the Americas and the Sisters of St. Dominic of the Most Holy Rosary, are publicly identified as sponsors of Dignity Health, with members serving on its board and in its hospitals.[21] The *Lown* test does not provide a straightforward way to evaluate such relationships. On the one hand, the Catholic Church plays no official role in the governance of Dignity Health. On the other hand, the orders' sponsorship and institutional participation suggest that Dignity Health receives assistance from the Catholic Church. Because the *Lown* test is a fact-intensive inquiry, it may provide little more guidance for some church-affiliated organizations than the statutory language of ERISA, even assuming the other requirements for the church plan exemption can be satisfied.

The exemption and the Establishment Clause. In addition to these questions of statutory interpretation, some of the cases that are still pending in the wake of *Advocate* assert more than ERISA-specific legal arguments against the church plan exemption. They also argue that, even if the plans in question could otherwise qualify as church plans under ERISA, the church plan exemption as applied violates the Establishment Clause of the First Amendment and is therefore void and ineffective.[22] The reasoning behind this argument is that the exemption "privileges those with religious beliefs (e.g., exempts them from neutral regulations) at the expense of nonadherents and/or while imposing legal and other burdens on nonmembers."[23] Although at least one federal district court has already dismissed such a claim as "singularly unpersuasive,"[24] such lower-court decisions are subject to appellate and Supreme Court review. Therefore, plaintiffs have identified a broad claim about the constitutionality of the church plan exemption and its application to church-affiliated organizations that could potentially trump any specific findings regarding ERISA.

Exempt status—State law in lieu of ERISA

Even if church-affiliated organizations obtain additional legal decisions confirming that they qualify for the church plan exemption, the fight over pension plan administration will not stop there. It will instead shift to the state courts. This logical result was acknowledged even prior to *Advocate.* In 2011, a federal district court judge in Minnesota found that a pension plan was not subject to ERISA, but permitted the plaintiff pension plan participants to proceed with state law claims of breach of promise and promissory estoppel (a third state law claim under the Minnesota Consumer Fraud Act was dismissed).[25] It continues to be a concern in the wake of *Advocate.* In an amended complaint filed on 8/28/17, the plaintiffs in *Cappello v. Franciscan Alliance, Inc.* have argued that if the court finds that the pension plan in

16 29 U.S.C. section 1002(33)(C)(iv).

17 238 F.3d 543 (CA-4, 2001).

18 *Id.* at 548 (*citing* Reg. 1.414(e)-1(d)(2)).

19 442 F.3d 648 (CA-8, 2006).

20 Selvam, "Catholic Healthcare West Ends Formal Ties to Church, and as Dignity Health Hopes It Can More Easily Add Non-Catholic Hospitals," Modern Healthcare, 1/28/12, available at www.modernhealthcare.com/article/20120128/MAGAZINE/301289993.

21 Dignity Health, "Religious Sponsors," available at www.supportdhfglobalmissionprogram.org/about-us/religious-sponsors.

22 Amended complaint, *Cappello v. Franciscan Alliance, Inc.*, No. 3:16-cv-00290-RLM-MGG (N.D. Ind., 2017).

23 *Id.* at 30.

24 Order re: Motions for Summary Judgment, *Medina v. Catholic Health Initiatives,* No. 13-cv-01249-REB-KLM (D. Colo., 2015).

25 *Thorkelson v. Publishing House of the Evangelical Lutheran Church in America*, 764 F.Supp.2d 1119 (D. Minn., 2011).

26 Amended Complaint, *Cappello, supra* note 22.

27 Minute Entry at 1, *Curtis v. Wheaton Franciscan Services., Inc.,* No. 1:16-cv-04232 (N.D. Ill., 2017).

28 Pension Rights Center, "Status of Church Plan Litigation," available at www.pensionrights.org/publications/fact-sheet/status-church-plan-litigation.

29 *Advocate*, *supra* note 2, at 137 S. Ct. 1657, fn. 2.

question is not subject to ERISA, the Franciscan Alliance has breached Indiana law of contract and of fiduciary duty.[26]

This change of venue and governing law does not necessarily improve the legal outlook for church-affiliated organizations. One reason is that many states do not have specific statutes analogous to ERISA. Instead, as indicated by the Minnesota and Indiana cases, the governing law will be based on the states' common law of trusts, fiduciary duties, and contracts, along with general statutes on those subjects and/or statutes addressing issues such as consumer fraud that plaintiffs will seek to apply to benefit plans.

In addition, unlike the uniform national regime under ERISA, church-affiliated organizations will potentially have to determine and become compliant with multiple sets of legal obligations that may vary by state. The reason is that, even though many church-affiliated organizations may be incorporated in a single jurisdiction where they first start operating or are headquartered, their operations may have expanded into many other states. In short, an exemption from ERISA does not guarantee that pension plans will, in fact, have fewer obligations to their participants.

In light of these various legal uncertainties, some church-affiliated organizations have chosen to settle rather than continue to litigate in the wake of *Advocate.* Thus, the parties in *Curtis v. Wheaton Franciscan Services, Inc.* informed a federal district court in Illinois on 7/17/17 that they had reached a settlement pursuant to their mediation subsequent to *Advocate.*[27] Although the terms of this recent settlement are not yet known, other plaintiffs have had success in obtaining lucrative settlements, including a $352 million settlement in *Griffith v. Providence Health Services,* a $98 million settlement in *Hodges v. Bon Secours Health System Inc.*, and a $75 million settlement in *Lann v. Trinity Health.*[28] Such amounts notwithstanding, further litigation at the district, appellate, and Supreme Court levels may prove untenable for other defendant church-affiliated organizations for other reasons, such as risk, time, and resources, regardless of the merits of the case. Notably, the decision in *Advocate,* which was ultimately favorable to church-affiliated organizations, took over four years to achieve and came after three unfavorable lower-court rulings that likely provided the impetus for other church-affiliated organizations to settle before the Supreme Court spoke.

Conclusion

Church-affiliated organizations need to determine the best position to assert with respect to the status of their plans under ERISA. The law as it stands after *Advocate* offers little guidance on the open legal questions addressed in this article. As Justice Kagan stated in her opinion, "[these] issues are not before us, and nothing in this opinion expresses a view of how they should be resolved."[29] Therefore, it remains to be seen whether *Advocate* will prove to be a pyrrhic victory in which church-affiliated organizations have won short-term success at a greater cost than may be worthwhile.