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Litigation Challenges to the Church Plan Definition: a Critical Issue for Church-Related Hospitals and Nonprofits

Background

Church plans have generally been exempt from ERISA and many provisions of the Internal Revenue Code since the inception of ERISA. As a result, church defined benefit plans in particular are not subject to the ERISA funding and vesting rules, and rules on interest rate and actuarial assumptions. Church defined benefit plans are also not covered by PBGC insurance and do not pay PBGC premiums.

This has become a matter of concern for participants in some underfunded defined benefit church plans. Prominent plaintiffs' law firms, aided by the Pension Rights Center, a well-known advocacy organization in Washington, D.C., have now targeted underfunded church defined benefit plans maintained by 501(c)(3) organizations which are not churches, claiming they are not entitled to the church plan exemption. Three cases were filed between March 28 and April 1, 2013, against Catholic Health East in the Eastern District of Pennsylvania, Ascension Health in the Eastern District of Michigan, and Dignity Health in the Northern District of California. Executives who were alleged to be fiduciaries were also named as defendants. It is not known whether more suits may be coming.

These follow two prior unsuccessful attempts by plaintiffs' firms to narrow the church plan definition. In a case involving the Hospital Center at Orange, the District Court of New Jersey in 2005 held that the case was not ripe because the IRS had indicated that it was reconsidering its ruling that the plans were church plans. In 2011, the District Court in Minnesota dismissed the complaint against the Augsburg Publishing House, rejecting the plaintiffs' interpretation of the church plan definition.

One reason that the plaintiffs' firms may be trying again may be indicated by a recent press release on the Pension Rights Center website which indicates that the IRS has now determined that the Hospital Center at Orange plans are not church plans. While the details have not been made public, the press release indicates that an important factor may have been that the plans had been subject to ERISA prior to 1998 when the hospital joined with a Catholic hospital that was controlled by the Archdiocese of Newark.

What's at Stake

The adverse consequences of a church plan failing to meet the church plan requirements are almost too numerous to mention, but the significant ones are:

- Failure to have satisfied ERISA, including:
 - Reporting and disclosure violations, which carry significant fines;
 - Minimum participation and vesting requirement failures, requiring that additional benefits be provided;
 - Coverage and funding requirement failures, likely requiring substantial additional contributions and catch-up payments to retirees with interest;
 - Violations by individual fiduciaries who have personal liability;
 - Prohibited transactions penalties carrying excise taxes on the amount involved beginning at 15% per year, which can increase to 100% per year; and
 - Liability for failure to pay PBGC premiums, plus interest and penalties.
- Failure to have satisfied the Internal Revenue Code:
 - The trust would likely lose its tax exemption and probably owe tax on its income;
 - Benefits would be subject to FICA, and if not withheld from employees' salary, the employer may be liable for the sums not withheld;
 - Possible immediate taxation of benefit accruals to plan participants;
 - Employer liability for failure to withhold income taxes on contributions for participants; and
 - Employer liability for failure to properly report participant distributions.

The Complaint in a Nutshell

All of the new complaints have as a centerpiece the argument that the church plan definition, particularly as modified in a 1980 amendment to ERISA, should be read to include only plans sponsored by a church or church pension board, and that it does not include plans sponsored by hospitals or other 501(c)(3) organizations controlled by or associated with a church. The complaints also argue that treating such plans as church plans violates the Establishment Clause of the U.S. Constitution. Plaintiffs assert numerous causes of action, including ERISA claims for many of the items noted above.

The Stakes are Large

This is not just about a particular hospital's conduct or underfunded defined benefit plans; it is about hundreds if not thousands of church-affiliated hospitals, colleges, universities, nursing homes, publishing houses and separately incorporated charities potentially becoming noncompliant with the Code and ERISA with respect to all their pension and welfare plans, with massive financial implications. In addition, the resolution seems likely to be affected by what happens in Washington, DC.

Groom Law Group has been a leading law firm in employee benefits since the inception of ERISA, and has considerable expertise both in high-stakes ERISA litigation and in the technical issues for church plans. Please contact your regular Groom attorney or one of the contacts listed in the sidebar if we can be of assistance with these issues.

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