

# Litigation Attacks on Church Plans: What Sponsoring Employers Need to Know Now

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About two weeks ago, two class action firms with ERISA class action experience filed lawsuits against three tax-exempt health care systems in Michigan, Pennsylvania and California. Each of those health care systems is affiliated with the Catholic Church. The lawsuits claim that these systems' pension plans - which are operated as ERISA-exempt church plans - are in fact subject to ERISA. Among other things, the lawsuits - brought against the employers and certain of their executives - allege that the plans do not comply with ERISA's funding standards, that ERISA-required notices and communications have not been furnished to participants, and that fiduciaries of the plans engaged in breaches of fiduciary duty and prohibited transactions in failing to operate the plans as if they were governed by ERISA. The suits also claim that the operation of the plans in question as church plans violates the Establishment Clause of the First Amendment.

These cases could have a profound effect on all church plan sponsors, regardless of whether they have previously obtained favorable church plan rulings from the IRS. This alert is designed to briefly discuss the claims made in the cases, and suggest some initial steps that church plan sponsors may take to protect themselves.

## The Assault on Church Plan Status: Three Basic Allegations

The complaints in these lawsuits rely on several theories to establish why the defendants' plans are not ERISA-exempt church plans, which can be distilled down to three basic arguments:

1. First, while the complaints acknowledge that church plans can cover employees of church-affiliated organizations (such as hospitals and universities), they claim that decades of established IRS and Department of Labor ("DOL") rulings and other court cases that permit church plan sponsorship by church-affiliated organizations are simply wrong. These rulings and court holdings endorse a model under which church-affiliated organizations establish church plans that are maintained by "church plan committees" or similar organizations established for the purpose of administering and funding church plans. The complaints claim that these regulators and courts are misinterpreting ERISA, and that ERISA requires that a church plan be established only by a church or convention of churches, not a church-affiliated organization.

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2. Second, all three actions allege that even if church-affiliated organizations can sponsor church plans, the defendants cannot because (at least currently) they operate too much like sophisticated health care systems and not enough like churches. First they argue, without elaboration, that the employers are not controlled by a church; second, they claim they are not associated with a church because they do not share sufficient “common religious bonds and convictions” with a church. Factors they have cited with regard to the “associated with” alternative test as to these three Catholic-affiliated systems include that:

- they offer or encourage interfaith spiritual support (including merely providing non-denominational worship space);
- they state that they do not favor Catholics when hiring;
- some of their facilities and physicians perform contraceptive and other services that the plaintiffs deem inconsistent with Catholic teachings; and
- the sponsors have acquired or become affiliated with other entities that have no significant ties to the Catholic Church.

In 2010, Plaintiffs' attorneys in these three new actions made the same claims in an action brought alternatively under ERISA and state law in the United States District Court in Minnesota. Although the court rejected their church plan arguments in a 2011 ruling, the case ultimately settled for \$4.5 million.

3. Finally, the complaints allege that the extension of the church plan exemption to plans that are not sponsored by churches or conventions of churches is an unconstitutional “accommodation” under the First Amendment.

Of course, analogous arguments could be brought against a church-affiliated organization of any religion or denomination.

## **Constitutional Argument**

The three lawsuits that have been filed all challenge the constitutionality of the church plan exemption as applied to plans sponsored by church-affiliated organizations. This is a new church plan challenge not yet addressed by the courts, although these courts' rulings on this issue may affect all such organizations that sponsor church plans, or might do so in the future. We intend to address the constitutional argument in a separate alert.

## **Overview of Key Implications**

There are a number of provisions under ERISA that apply to ERISA-covered plans but not to church plans. Some of the key differences include:

- Probably most importantly, ERISA plans are subject to the minimum funding standards set forth in ERISA and the Internal Revenue Code. Church plans are exempt from these standards.
- ERISA plan participants are required to be furnished with certain notices regarding plan

funding, benefit freezes and reductions, and other matters. Church plans are not required to provide these notices.

- ERISA plans are subject to the statute's prohibited transaction provisions.
- Finally, ERISA defined benefit plans are required to pay significant premiums to the Pension Benefit Guaranty Corporation, while church plans are not.

Of course, these cases are in their infancy, and we anticipate that the defendants will aggressively defend their church plans' status. Even if any of these plaintiffs prevail, it is far from clear what, if any, consequences would result.

## **Initial Steps to Consider**

We think these cases should fail in light of years of contrary IRS and DOL guidance and court decisions. However, even though ERISA may not apply, state law will, and there are some steps that church plan sponsors should consider taking even if they are not currently defendants in one of these lawsuits:

- Review existing church plan rulings, identify any factual circumstances that may have changed since the rulings, and discuss with counsel whether those changes could affect those rulings and whether an updated ruling should be requested from the IRS;
- Review with plan counsel your organization's general compliance with church plan and applicable state law requirements to determine potential areas of vulnerability;
- Coordinate closely with upper management and plan fiduciaries to make sure all affected parties are aware of risks and the need to maintain sensitivity regarding internal and external communications;
- Designate a "point person" to handle inquiries by plan participants and others;
- Work with legal counsel to develop an appropriate response to inquiries by participants, keeping in mind that those same participants may have already been contacted by – and may be acting on behalf of – an attorney representing a potential class of plaintiffs; and
- Compile and review all insurance policies that might possibly provide coverage to the employer if it is named as a defendant in one of these cases.

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