Church-Affiliated Employers Get Win As SCOTUS Clarifies ERISA Exemption

Insights
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In a unanimous 8-0 decision published today, the U.S. Supreme Court (SCOTUS) ruled that employee benefit plans sponsored by church-affiliated organizations will qualify for the "church plan" exemption under the Employee Retirement Income Security Act (ERISA) regardless of whether the plan was originally adopted or established by a church. This decision is a huge win for those church-affiliated employers such as hospitals and schools which have historically relied on the exemption from ERISA in the design and administration of their benefit programs (*Advocate Health Care Network v. Stapleton*).

Background
ERISA was enacted to protect the interests of employee benefit plan participants and their beneficiaries and contains a comprehensive regulatory scheme. The regulation of employee pension and retirement plans under ERISA is especially complex and includes minimum funding obligations and other increased protections for pension plan participants.

Given this extensive regulatory regime, Congress carved out an exemption for "church plans" to prevent excessive government entanglement with religion. For this purpose, a "church plan" is defined in ERISA Section 3(33)(A) as a "plan established and maintained . . . by a church or by a convention or association of churches . . . ." The basic definition was amended in 1980 to provide that:

"A plan established and maintained for its employees (and their beneficiaries) by a church or convention or association of churches includes a plan maintained by an organization . . . the principal purpose of function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches."

An issue in this case is the conflicting interpretations of the 1980 amendment, which the Supreme Court acknowledged is a "mouthful" even for lawyers. Under the first interpretation, the church plan exemption only applies if the plan being "maintained" by the organization described in the amendment, which is referred to as a "principal purpose" organization, was originally established by a church. Under the second interpretation, the principal purpose organization's employee benefit plans are exempt from ERISA regardless of whether established by the church.

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The Internal Revenue Service, Pension Benefit Guaranty Corporation (PBGC) and the U.S. Department of Labor favor the second interpretation. According to the federal agencies, the internal benefits committees of church-affiliated nonprofits qualify as principal-purpose organizations, and the agencies have issued hundreds of letters and opinions since with 1980s directing church-affiliated organizations that their plans are exempt from ERISA.

Origin Of Conflict

Despite the longstanding agency interpretations, three federal appeals courts recently affirmed lower court decisions finding that the church plan exemption should be more narrowly construed. The 3rd Circuit concluded that the church plan exemption has two requirements, which are "establishment" and "maintenance." That court then reasoned that the 1980 amendment only expanded the maintenance requirement to allow certain principal-purpose organizations to maintain a plan pursuant to the church exemption, but did not amend the requirement that the plan first be established by the church. The 7th and 9th Circuits relied on similar statutory interpretations to conclude the church plan exemption from ERISA only applies if the plan is first established by a church (*Kaplan v. Saint Peter's Healthcare Sys.*, *Rollins v. Dignity Health*, and *Stapleton v. Advocate Health Care Network*).

These three cases, which wound their way to the Supreme Court, are just a few of the recent cases challenging the exemption from ERISA of pension plans sponsored by church-affiliated organization. As Justice Sotomayer pointed out in a concurring opinion, these organizations often look and operate more like secular organizations and compete with for-profit entities without the burden of ERISA compliance.

The primary concern of the participants bringing these actions is that, unlike retirement plans of similarly situated employees working for secular employers, the exemption from ERISA leaves their retirement benefits at risk because ERISA's fiduciary, vesting, and funding requirements do not apply. In light of the importance of the issue to the numerous nonprofits relying on the exemption, the SCOTUS agreed to hear these three cases and consolidated them for review.

The Supreme Court's Interpretation

In the unanimous decision drafted by Justice Kagan, the Supreme Court reversed the Circuit Court decisions in all three cases and held that ERISA does not require a church to first establish a plan for the plan of a church-affiliated entity to be exempt from ERISA. The Supreme Court's decision focuses primarily on statutory construction of the original definition of church plan in ERISA Section 3(33)(A) and the 1980 amendment that added ERISA Section 3(33)(C). Justice Kagan provides the following "user-friendly" version:

"Under paragraph (A), "a 'church plan' means a plan established and maintained . . . by a church."

"Under subparagraph (C)(i), '[a] plan established and maintained . . . by a church . . . includes a plan maintained by [a principal-purpose] organization.'"

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The SCOTUS emphasizes that use of the term "includes" means that Congress intended for a "different" type of plan identified in subparagraph (C)(i) to receive the same exempt treatment from ERISA as a plan established and maintained by a church under paragraph (A). The Supreme Court then used logic to demonstrate that the type of plans newly eligible for the exemption under subparagraph (C)(i) are those that are maintained by a principal-purpose organization. As the Court explained, since Congress deemed a category of plans established and maintained by a church to be exempt under paragraph (A), and provides in subparagraph (C)(i) that a plan established and maintained by a church includes a plan maintained by a principal purpose organization, it necessarily follows that both types of plans must be exempt from ERISA.

The opinion then goes into a lengthy discussion regarding proper statutory construction in rejecting the participants' more narrow interpretation of the exemption. The opinion also analyzes the difference between the terms "establish" and "maintain" in the context of ERISA plans, concluding that the terms are often used interchangeably. In terms of compliance with ERISA's regulatory scheme, the Court said, it is of more significance which entity maintains a plan than who originally established the plan.

In further support of the Court's holding, the opinion also addresses the consistency of the Supreme Court's interpretation with Congress' apparent goal when adopting the 1980 amendment. The hospitals claimed the amendment was a reaction to a controversial IRS ruling that found a pension plan established by an order of nuns for their hospital employees was not a church plan because the order was not carrying out the religious functions of the church. According to the hospitals, many religious groups protested the ruling and IRS's role in defining what constitutes a church, so Congress was prompted to expand the exemption.

In the concurring opinion, Justice Sotomayer agrees with the statutory interpretation of ERISA Section 3(33), but expresses concern regarding the outcome, especially given the lack of documented legislative history. Noting that church-affiliated organizations such as the hospitals being sued in these cases include some of the largest healthcare providers in the country and often have for-profit subsidiaries, Justice Sotomayer questioned whether Congress would have adopted the same amendment today. Her concurring opinion suggests that Congressional action narrowing the exemption may be on the horizon.

What This Means For Employers

Church-affiliated employers can finally breathe a big sigh of relief knowing their pension plans and other benefit programs will not retroactively be deemed in violation of ERISA's many requirements. The potential cost to bring those plans in compliance, including retroactive penalties, was represented at oral argument to be in the billions. That number is not difficult to justify considering the thousands of employees covered under pension plans and other plans of church-affiliated entities relying on the exemption.

While today's decision brings clarity and support to the very broad scope of the church plan

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exemption, church-affiliated employers should continue to monitor further developments in the event Congress attempts to limit the scope of the church plan exemption in light of today's decision.

If you have any questions about this decision or how it may affect your business, please contact your Fisher Phillips attorney or any member of our Employee Benefits Practice Group.

This Legal Alert provides an overview of a specific Supreme Court decision. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

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Lorie Maring
Partner
404.240.4225
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