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District Court Rebukes IRS Church Plan Rulings.

David Cay Johnston reports on the first court case in an expanding effort to exempt pension plans from ERISA on religious grounds; the decision implicitly criticizes the IRS Office of Chief Counsel.

The IRS Office of Chief Counsel came in for sharp criticism from a federal judge in the first significant decision in five lawsuits by workers who complain that the IRS is helping employers quietly strip away their pension rights.

Hundreds of thousands of workers at hospitals and other nonprofit organizations have been moved into so-called church pension plans, which are exempt from ERISA. IRS private letter rulings enabled each of these moves.

Most of the nonprofits that were granted IRS approval to operate as church plans exempt from ERISA were seriously under funded, the trustees having failed to set aside enough money to pay the old-age benefits workers had earned. The federal government guarantees the pensions of workers in ERISA plans, although when a plan fails, workers typically get less than they had been promised. Workers moved into church plans, however, lose the federal guarantee.

The five cases don't involve plans run by churches, but those operated by groups that claim a religious affiliation of some kind even though they may have for-profit partners, operate commercial businesses, and engage in activities that violate the doctrine of the affiliated religion. If the workers lose the five cases, there will be a swift expansion of church plans.

In some cases the plans always operated outside ERISA. In most cases, however, workers in ERISA plans were absorbed into church plans following approval from the IRS chief counsel.

Workers generally were not told about the valuable government guarantee they lost, although current IRS policy requires notifying workers. Many of these plans asked for, and got, refunds of insurance premiums paid to the Pension Benefit Guaranty Corporation when they operated subject to ERISA.

Rollins v. Dignity Health

The action in the first case came after a motion to dismiss by lawyers for Dignity Health, which covers 60,000 workers in Arizona, California, and Nevada. Dignity sought to dismiss a putative class action lawsuit brought by Starla Rollins, a longtime billing office employee .

District Judge Thelton E. Henderson denied the motion . His ruling amounts to a public thrashing of IRS chief counsel.

The chief counsel's private letter rulings are shocking because ERISA makes pension administrators fiduciaries, a necessity because the administrators are typically employees of the sponsoring nonprofit or company and have divided loyalties. Section 404(a)(1) requires plan administrators to act "solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses."

Taking away a guaranteed income in old age cannot possibly meet the “solely and exclusively” test, indicating IRS chief counsel turned a blind eye to this standard in these private letter rulings.

The complaint filed by Bruce F. Rinaldi and Karen L. Handorf of Cohen Milstein Sellers & Toll PLLC and by Lynn Sarko of Keller Rohrback LLP argues that “Dignity plainly is not a church or a convention or association of churches” and that the pension was “not established by a church or a convention or association of churches,” as the law requires of church plans. “Dignity is not owned by the Catholic Church” and “does not receive funding from the Catholic Church or other religious organizations,” according to the plaintiffs.

The plaintiffs argue that Dignity:

is long since removed from the days when nuns once ran the hospitals, spread the gospel, and faithfully stewarded retirement assets for their employees. Dignity deliberately chooses to distance itself from, or even abrogate, many religious convictions of the Catholic Church, when it is in its economic interest to do so, such as when it hires employees, performs or authorizes medical procedures forbidden by the Catholic Church, and encourages divergent and contrary spiritual support to its clients.

Only two of nine Dignity directors are nuns. The executive ranks are composed entirely of lay people. CEO Lloyd H. Dean was paid more than $6 million in 2011, including more than $1 million to his retirement plan. A dozen other employees made between $1.1 million and $2.9 million. Last year Dignity paid more than $2.7 million just to persuade four executives to go away, its Form 990 shows.

In 2012 Dignity bought U.S. HealthWorks, a for-profit operator with 2,700 employees, which has “no claimed ties to religion.” “Dignity’s current growth model specifically targets the acquisition of additional healthcare facilities that have no claimed ties to religion,” according to the complaint. “These facilities do not purport, and have never purported, to adhere to the moral and doctrinal teachings of the Catholic Church.”

That point is significant because if Dignity prevails, it would open the door to organizations claiming religious affiliation to get exempted from ERISA and then take over for-profit enterprises and operate for-profit affiliates, just as Dignity does. That could strip multitudes of their government-guaranteed pensions.

The plaintiffs say that allowing Dignity a church plan exemption “violates the establishment clause [of the First Amendment] because it harms Dignity employees, puts Dignity competitors at economic disadvantage and relieves Dignity of no genuine religious burden created by ERISA.”

Dignity operates ERISA-governed health and welfare benefit plans, dependent life insurance plans, and short-term disability plans, filing the necessary Forms 5500 each year with the IRS and the Labor Department. So Dignity runs ERISA plans, fully complying with the law, when it chooses, but claims a church plan exemption for its pension plan. How could the IRS chief counsel fail to have noticed this discrepancy?

Significantly, Dignity’s lawyers do not assert that it is owned and operated by the Catholic Church. Instead, they write about how a “healing ministry is a central component” of the church’s mission and note that Dignity “operates 24 Catholic and 15 non-Catholic hospitals.”

Catholic hospitals follow church doctrine. But in court papers, Dignity said its non-Catholic hospitals provide contraceptive and sterilization services. This argument presents a real problem for Dignity. If artificial contraception and sterilization violate church teaching, how can Dignity countenance their being provided at any facility under its embrace? And since it does, how can its pension qualify as a church plan?

Lawyers for Dignity disagree with the First Amendment claim, arguing that no unfair advantage can arise from its pension being exempt from ERISA because no law requires employers to provide retirement benefits. Point made — for this case. But the argument has a broader policy implication that cuts against Dignity.

Dignity's argument, if adopted, would put pressure on competing employers subject to ERISA to jettison their pension plans. Exempt employers can promise workers benefits without setting aside money each year to pay them, while an employer subject to ERISA must fund its plan. Competitors subject to ERISA could try to persuade workers that they are better off because their pension is guaranteed and the competition's plan may be a fraud. But that argument is both esoteric and unlikely to get past in-house counsel's warnings about libel litigation.

The other option would be not to offer a pension, which goes against the express intent of the 1974 pension law. The policy question Dignity's lawyers present is whether the tax aspects of pension law should discourage those plans when Congress expressly said its intent was to promote pensions and their sound funding.

Letter Rulings

In its motion to dismiss, Dignity relied heavily on four IRS private letter rulings. A predecessor, Catholic Hospitals Healthcare West, obtained the first (LTR 9409042). The IRS concluded the pension was a church plan from the get-go, a ruling whose validity the plaintiffs challenge.

The bigger problem is with three subsequent rulings — in 1995 (LTR 9525061), 1997 (LTR 9717039), and 2000 (LTR 200023057). They were sought because of "mergers with hospitals that maintained ERISA-governed pension plans." The IRS enabled the stripping of a valuable government guarantee from workers, and the organization that did the stripping, Dignity, admits it.

The loss of a pension guarantee cannot possibly benefit workers, but it could be a boon to pension plan trustees who violated their duty of loyalty. A private letter ruling means escape from civil litigation and any risk of indictment for fraud. That the IRS chief counsel issued the first private letter ruling may be problematic and even, as the plaintiff claims, improper.

But the three later private letter rulings are clearly at odds with the legal standards both in the original 1974 pension protection law and the 1980 addendum. If the Dignity mergers had been with other church-run hospitals, the issues would be murky, but the hospitals and other operations Dignity took over were not church-run. Some of them are commercial for-profit enterprises.

Motion Denied

Henderson paid no heed to the private letter rulings, saying he need not even read them. Private letter rulings "apply only to the persons or entities who request them and are not entitled to judicial deference," he said. He conducted his own analysis, coming to conclusions that evinced little to no support for the arguments made by Dignity.

The judge focused on the requirement that to be exempt, a pension plan must be "established and maintained . . . by a church" or by a church-associated organization created to administer a church pension plan. Then he turned to section A of the 1980 law, which contains the established language, writing that it is inextricably intertwined with section C:

Although Dignity's proposed reading of the statute is not unreasonable on its face, it violates long-held principles of statutory construction and therefore cannot be the meaning of the statute.

To began, Dignity's reading violates a "cardinal principle of statutory construction. . . . To give effect, if possible, to every clause and word of a statute rather than to emasculate an entire section."

If, as Dignity argues, all that is required for a plan to qualify as a church plan is that it meet section C's requirement that it be maintained by a church-associated organization, then there would be no purpose for section A, which defines a church plan as one established and maintained by a church. . . .

Dignity's reading not only renders section A meaningless, but also disregards the limiting language of section C (i), that to maintain a church plan, an organization must not only be associated with the church, but it must have as its "principal purpose or function . . . the administration or funding of a [benefits] plan or program . . . for the employees of a church." Dignity is a healthcare organization; its mission is the provision of healthcare, not the administration of a benefits plan.

That's exactly how the law should be read. It is a withering indictment of chief counsel for issuing private letter rulings that cannot possibly be in the interests of workers in ERISA plans.

Dignity said it was unswayed. A statement distributed by Dignity's director of strategic communications, Tricia Griffin, said the firm "values the contributions our employees make to our mission, and we remain committed to ensuring our retirees and beneficiaries receive the benefits they have earned. We are disappointed in the recent decision by Judge Henderson, but will continue to defend the case."

Dignity said it was relevant that it provided $1.6 billion in a combination of charity care, community benefits, and services for which the bills went unpaid.

Dignity's charity care is so insignificant that Deloitte LLP did not even mention it in its 49-page audit of Dignity. However, more than eight pages were devoted to the troubled pension plan, which was badly funded in 2011 and became even worse in 2012.

Dignity said it owes its workers $3.7 billion in benefits, but at the end of last year it had only $2.4 billion set aside to pay them. In 2011 funding was better, with three-quarters of the necessary funds invested.

The 9 percentage point drop in the pension plan funding ratio occurred even though Dignity cut pension benefit accruals, according to the Deloitte audit. So much for Dignity's written statement asserting that it "values" its employees.

The record shows Dignity to be an amalgam of nonprofit and commercial activity not owned by, and arguably not even established by, the Catholic Church. Its financial disclosures show it is run with hardly more regard for charity than any of several for-profit corporations that describe themselves as socially responsible.

A pending request by Dignity for a fifth IRS private letter ruling provides chief counsel with a golden opportunity to set this matter right. Citing Henderson, or just relying on his insights without credit, chief counsel can reject Dignity's private letter ruling. It can renounce its past private letter rulings for not complying with the 1980 law, for ignoring the "solely and exclusively" requirement, and for favoring feckless trustees and the entities that employed them without regard for the interests of the workers whose pension rights were taken away.

Multitudes of workers toiling away in the expectation that their pensions will be there when their hair turns gray can only hope that IRS chief counsel recognizes that to err is human, to correct divine.

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