For Whom the Bell Tolls

ERISA's Church-Plan Exemption and the Principal-Purpose Organization

By Ian Linker

Federal statutes are hardly models of clarity. An understatement, I know. And the Employee Retirement Income Security Act of 1974 (ERISA) is no exception. One provision in particular has gotten considerable attention in the courts recently: ERISA's church-plan exemption. The exemption has spawned a ton of litigation, always a sign that a statute is flawed, or ambiguous at a minimum, particularly for something that should be an easy question: what is a church plan.

Church plans, like government plans, are exempt from ERISA's sometimes-stringent requirements. So whether a benefit plan is a church plan can have a profound impact on the plan, its fiduciaries, its participants and beneficiaries, and the applicable law.

The Statute

Under ERISA:

> The term "church plan" means a plan established and maintained (to the extent required in clause (ii) of subparagraph (B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 of title 26.
>
> The term "church plan" does not include a plan—
>
> > which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of title 26), or
> >
> > if less than substantially all of the individuals included in the plan are individuals described in subparagraph (A) or in clause (ii) of subparagraph (C) (or their beneficiaries).
>
> For purposes of this paragraph—
>
> > A plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches 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 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.
> >
> > The term employee of a church or a convention or association of churches includes—
> >
> > (I) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation;
> >
> > (II) an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of title 26 and which is controlled by or associated with a church or a convention or association of churches; and
> >
> > (III) an individual described in clause (v).

29 U.S.C. §1002(33).

The Supreme Court Weighs In: *Advocate Health Care v. Stapleton*

The Supreme Court recently addressed the church-plan exemption. In *Advocate Health Care Network v. Stapleton,* _ U.S. _, 137 S. Ct. 1652 (2017), the Court consolidated three related cases and considered whether a church must have originally established its benefit plan for it to qualify for the exemption. The Court unanimously held, no.

The defendants were three not-for-profit church-affiliated hospitals that established defined benefit plans for their employees. The defendants had internal benefit committees administer the plans. Plaintiffs, current and former hospital employees, filed suit alleging that the hospitals' pension plans are not church plans; thus, they are subject to ERISA's funding requirements.

The Court began with the history of the church-plan exemption. Since its enactment in 1974, the Court noted, the exemption provided that church plans were plans established and maintained for church employees by a church or convention or association of churches. 29 U.S.C. §1002(33)(A). In 1980, Congress added subparagraph (C), the source of the dispute; described by the Court

as a "long-winded" "description of a particular kind of church-associated entity," referred to thereafter by the Court as a "principal-purpose organization."

The plaintiffs argued that because the plans at issue were "not established by a church"—even if they were maintained by a principal-purpose organization—the exemption should not apply. Accordingly, the plaintiffs argued, paragraph (A)'s requirement that a church establish and maintain the plan for it to qualify as a church plan extended to paragraph (C)'s maintained-by-a-principal-purpose-organization language. The district courts agreed and the Third, Seventh, and Ninth Circuits affirmed.

Accordingly, the case turned on how to interpret paragraphs (A) and (C) in conjunction with each other. The parties agreed that a principal-purpose organization or a church could maintain a plan to qualify for the church-plan exemption. The dispute arose, however, because the parties disagreed over whether a non-church could establish a plan to qualify for the exemption or whether the exemption reserved establishment to a church.

The hospitals argued that paragraph (C) brought within the exemption all plans maintained by a principal-purpose organization, regardless of who or what established them. The plaintiffs argued a church needs to establish the plan to qualify for the exemption. The Supreme Court, however, agreed with the hospitals.

The Court reasoned that "church plan" initially meant a plan established and maintained by a church, but under paragraph (C) a church plan now could include something more: "a plan maintained by [a principal-purpose] organization, … irrespective of [its] origin." The Court instructed: "a different type of plan should receive the same treatment (*i.e.,* an exemption) as the type described in the old definition."

The Court explained its logic as follows:

> Premise 1: A plan established and maintained by a church is an exempt church plan.
>
> Premise 2: A plan established and maintained by a church includes a plan maintained by a principal-purpose organization.
>
> Deduction: A plan maintained by a principal-purpose organization is an exempt church plan.

And the Court boiled down its reasoning as follows:

> If A is exempt, and A includes C, then C is exempt.

Thus, all plans maintained by a principal-purpose organization are exempt from ERISA.

The Court next considered and addressed plaintiffs' arguments. The Court explained that plaintiffs' interpretation of subparagraph (C) did not hold up to scrutiny, because:

> [The Court's] practice … is to give effect, if possible, to every clause and word of a statute. … And here, that means construing the words "established and" in [subparagraph (C)] as removing, for plans run by principal-purpose organizations, paragraph (A)'s church-establishment condition.

Had Congress sought to exempt plans established by a church, it could have easily done so, albeit "with an altogether different meaning," by enacting subparagraph (C) without the words "established and." But Congress did not write the subparagraph this way; instead, it drafted it as it is written; included in the definition of church plan all plans maintained by a principal-purpose organization, regardless of who or what establishes the plan.

The plaintiffs argued that the Court should interpret subparagraph (C) to "'modify[] only the criterion' in paragraph (A) that 'it expressly expands (maintained), while leaving the other criterion (established) unchanged.'" Plaintiffs based this suggested interpretation on the following principle:

> [I]f a definition or rule has two criteria, and a further provision expressly modifies only one of them, that provision is understood to affect only the criterion it expands or modifies.

The Court noted that the plaintiffs cited to no "precedent or other authority" to support their interpretation. "[T]he criteria at issue [in subparagraph (C)] —establishment and maintenance—are not unrelated." Each "describe[s] an entity's involvement with [an ERISA-governed] plan. Establishment is "a necessary precondition" of maintenance. And "ERISA treats the terms … interchangeably": "an amendment altering the one requirement could naturally alter the other too," not an "utterly untenable result."

Ultimately, the Court concluded, "[u]nder the best reading of the statute, a plan maintained by a principal-purpose organization therefore qualifies as a 'church plan,' regardless of who established it."

But what the Court did not say is almost as significant as what it did say. The Court stated in footnote 2 of the decision that two questions elucidating whether the church-plan exemption would apply were not before the Court; thus, it did not decide the issues and remanded them to the district courts: whether the defendant hospitals had the "needed association with a church," and if so, whether the hospitals' internal benefit committees

constitute a principal-purpose organization. Consequently, it is not surprising that the courts deciding church-plan exemption issues since *Advocate Health Care* have focused their analysis on these issues.

The Tenth Circuit Decides *Medina*

Medina v. Catholic Health Initiatives, 877 F.3d 1213 (10th Cir. 2017), was pending when the Supreme Court decided *Advocate Health Care*.

The defendant in *Medina*, a non-profit organization, operates over 90 hospitals and several other healthcare facilities. The defendant offers a retirement plan for its employees, with more than 90,000 participants and beneficiaries, and nearly $3 billion in plan assets. A subcommittee of the defendant administers the plan.

In *Medina*, the Tenth Circuit considered the two issues the Supreme Court expressly did not decide:

- Whether the defendant's internal benefits committee qualifies as a principal-purpose organization; and
- Whether the defendant has the "requisite level of association" with a church.

The Tenth Circuit also considered whether the church-plan exemption, generally, runs afoul of the Establishment Clause of the First Amendment of the U.S. Constitution.

The court applied the following "three-step inquiry," imposed by ERISA, in deciding whether the church-plan exemption applied to an entity "seeking to use the … exemption for plans maintained by [a] principal-purpose organization":

- Whether the entity is a "tax-exempt nonprofit organization associated with a church";
- If so, whether the entity's benefit plan is maintained by a principal-purpose organization; and
- If so, whether the principal-purpose organization is associated with a church.

The court held that the answer must be yes to all three for the exemption to apply and noted that both the "entity whose employees the plan benefits" and the principal-purpose organization "must be associated with a church."

The court concluded that defendant satisfied step one, because in accordance with ERISA, defendant was tax exempt and "shares common religious bonds and convictions with [the] church." 29 U.S.C. §1002(33)(C)(iv). Defendant was connected to the Roman Catholic Church through the Church's canon law; was listed by the Church in its official directory as a Roman Catholic institution and an official part of the Church. The Internal Revenue Service considers any organization listed in the directory to be "associated with" the Church for purposes of applying ERISA's church-plan exemption.

The plaintiff, however, urged the Court to apply the following "three non-exclusive factors" used by the Fourth Circuit in *Lown v. Continental Casualty Co.,* 238 F.3d 543 (4th Cir. 2001), and by the Eighth Circuit in *Chronister v. Baptist Health,* 442 F.3d 648 (8th Cir. 2006), to determine whether defendant was associated with the Roman Catholic Church, rather than apply the language of the statute:

- "[W]hether the religious institution plays any official role in the governance of the organization";
- "[W]hether the organization receives assistance from the religious institution"; and
- "[W]hether a denominational requirement exists for any employee or patient/customer of the organization."

It is noteworthy that neither the Fourth Circuit nor the Eighth Circuit found the entity in question associated with the religious institution in the case, because none of the foregoing factors was present.

The Tenth Circuit in *Medina*, however, found these so-called "*Lown* factors … narrower than the broad [statutory] language," which contains none of the governance, assistance, or denominational requirements applied in *Lown*. The court noted that an organization could satisfy the statute if it "shares common religious bonds and convictions with that church," without satisfying a single *Lown* factor; thus, the court rejected *Lown* and held the defendant satisfied the first of the three-step inquiry, finding whether the defendant was associated with the "Catholic Church is not a close question."

The court next turned to step two: Whether a principal-purpose organization maintained the plan. The plaintiff questioned whether the defendant or the defendant's benefit subcommittee was the relevant "organization" and disputed the meaning of "maintain." The plaintiff argued that the defendant healthcare system was the organization; thus, not a principal-purpose organization, since it was a hospital, first and foremost, and argued that the defendant maintained the plan, even though plaintiff conceded the benefit subcommittee administered the plan.

ERISA defines neither "organization" nor "maintain," so the court gave the terms their "ordinary meaning." After consulting dictionaries for guidance, the court found that maintains the plan means "cares for the plan for purposes

of operational productivity," which was precisely the defendant's point. "Maintain" does not mean the power to amend or terminate the plan, as plaintiff argued. Moreover, the plan "expressly delegates the power" to the subcommittee to maintain the plan. Accordingly, the court found the subcommittee maintained the plan.

But was the subcommittee itself an organization? The court found that both the defendant and the subcommittee qualified as organizations. An "organization" is a "body of persons … formed for a common purpose," or a "group of people that has a more or less constant membership, a body of officers, a purpose, and usually a set of regulations." The subcommittee had a common purpose: to provide "for the proper operation, administration and maintenance of the Plan." Thus, the court found the subcommittee was a principal-purpose organization.

Finally, the court considered step three: whether the subcommittee was associated with the Catholic Church. The court answered this question affirmatively: Because the defendant was associated with the Church and because the subcommittee was "wholly encompassed" by the defendant, both entities share the same associations, including the defendant's association with the Church. Further, the subcommittee may have been associated with the Church, in its own right. Indeed, the plan instructed the subcommittee to "be mindful of the Employer's Philosophy and Mission, and the teachings and tenets of the Roman Catholic Church."

Next the court considered plaintiff's Establishment Clause argument. The First Amendment states, "Congress shall make no law respecting an establishment of religion." Assessing plaintiff's challenge thereunder, the court applied the three-part test articulated in *Lemon v. Kurtzman,* 403 U.S. 602 (1971), providing:

> [G]overnment action does not violate the Clause if (1) it has a secular purpose; (2) its principal or primary purpose neither advances nor inhibits religion; and (3) it does not foster an excessive government entanglement with religion.

With respect to the first prong, the court considered whether Congress "was motivated by an intent to endorse religion" in enacting ERISA's church-plan exemption. When a court can "discern a plausible secular purpose," it will be reluctant to "attribute unconstitutional motives to the government." The court concluded that it is plausible that Congress "wanted to avoid unnecessary entanglement with religion"; thus, it had a secular purpose.

The court next considered the second prong: whether the exemption's primary purpose advances or inhibits religion. The court concluded that government acts with "the proper purpose" when it eases restrictions on the "exercise of religion." Accommodating religion does not equal favoring religion. Accordingly, ERISA's church-plan exemption does not have the principal or primary purpose of advancing religion.

Finally, the court considered whether the exemption creates or fosters an unnecessary entanglement with religion. The court held it does not. In fact, as stated above, it avoids the entanglement. Thus, the court held the church-plan exemption does not run afoul of the First Amendment's Establishment Clause.

The court rejected plaintiff's arguments and affirmed the district court's finding that the church-plan exemption applied.

Recent District Court Decisions

Four district courts have opined on the issues pertinent here since *Medina*.

In a slightly different twist on these issues, the court in *Sheedy v. Adventist Health Sys. Sunbelt Healthcare Corp.,* 2018 U.S. Dist. LEXIS 122153 (M.D. Fla. July 23, 2018), considered whether a complaint contained sufficient allegations that ERISA applied, *i.e.,* the church-plan exemption did not apply. Specifically, plaintiff alleged in the complaint that defendant nonprofit hospital system, a non-church, established and maintained a defined-benefit plan for the benefit of the defendant's employees. Thus, plaintiff argued, it was not a principal-purpose organization as defined by 29 U.S.C. §1002(33)(C), because its principal purpose was to provide healthcare. The defendant hospital moved to dismiss, arguing it was associated with a church and that it did not maintain the plan as a matter of law; various benefit committees created by the defendant maintained the plan.

The court denied the motion and held that the plaintiff sufficiently alleged that the defendant maintained the plan – ultimately, a fact question – and since the defendant was a hospital, in addition to being the plan administrator, it was not a principal-purpose organization. And so at the motion to dismiss stage, the plaintiff sufficiently alleged that the church-plan exemption did not apply.

In *Sanzone v. Mercy Health,* 2018 U.S. Dist. LEXIS 145195 (E.D. Mo. Aug. 27, 2018), the court considered many of the same post-*Advocate Health Care* issues considered by the Tenth Circuit in *Medina.*

Defendant was a "nonprofit corporation operating one of the largest Catholic healthcare systems in the United States." Defendant had more than 40,000 employees or retirees. It offered a pension plan for its employees and retirees and designated an internal benefits committee as plan administrator. The plan states defendant's intention to maintain the plan as a church plan, exempt from ERISA. Plaintiffs were retirees and other former employees of the defendant.

Defendant moved to dismiss the complaint on the grounds that the court lacked subject-matter jurisdiction and the complaint failed to state a claim. The court recognized at the outset that if the church-plan exemption applied, and ERISA did not apply, then there would be no federal question; thus, the court would have no subject-matter jurisdiction.

Plaintiffs argued the plan is not exempt from ERISA, because it was not a church plan. And even if the plan was a church plan, ERISA's exemption violates the First Amendment's Establishment Clause.

The court considered the following issues:

- Who maintains the plan?
- Is it a principal-purpose organization?
- Is it associated with a church?
- Are "substantially all" of the plan participants church employees?

Maintenance

Following the *Medina* court's lead, the court in *Sanzone* considered the common-usage meaning of "maintain" and determined that "under the totality of the circumstances," the internal benefits committee maintained the plan.

After reviewing the case law, the court determined that plaintiffs' argument that "maintain" also must include the power to terminate the plan was "contrary to the term's ordinary usage."

Accordingly, because the committee had "sole responsibility" for administering and discretion to administer the plan, adopting rules for and interpreting the plan, communicating with plan participants about coverage, administering claims for benefits, among other things, it maintained the plan.

Organization

Also following *Medina*, the court also considered the common-usage meaning of "organization": "an administrative and functional structure," or "a group of people who work together in an organized way for a shared purpose." The court found no definition requiring an organization "to be a wholly independent and separate entity from a larger group of which it is a part," as plaintiffs argued. In other words, an organization can exist within another organization and still be an organization.

Once the court found the internal benefits committee to be a "body of persons formed for a common and particular purpose and has specific and exclusive responsibilities to further this purpose," it determined the committee was not just an organization, but a principal-purpose organization.

Associated with a Church

The court held the defendant was associated with the Roman Catholic Church, because as required by the statute, it "shares common religious bonds and convictions with the church." Indeed, the "substantial evidence" of association included: defendant was "governed by and operate[d] in furtherance of the principles of the Roman Catholic Church"; and "it operate[d] exclusively for religious, charitable, scientific, and educational purposes," among other things. These "extensive indicia … conclusively demonstrate[d] that [defendant] is 'associated with a church.'"

Interestingly, the district court, which sits within the Eighth Circuit, used the Tenth Circuit's approach in *Medina*, *i.e.,* applying the express statutory language, in determining association with a church, rather than the narrower *Lown* factors, applied by the Eighth Circuit in *Chronister*.

"Given that [defendant] is associated with a church, application of simple logic as the Supreme Court did in [*Advocate Health Care*] shows that the [internal benefit committee] must necessarily be associated with a church."

"Substantially All" of the Employees

"To qualify for the church-plan exemption, 'substantially all of the individuals included' in a church plan must be deemed employees of a church." The court found that the defendant was associated with a church and because the more than 40,000 employees worked for defendant, the defendant's employees must also be employees of a church.

Accordingly, the court found that the exemption applied; thus, ERISA did not apply.

Establishment Clause

In response to plaintiffs' argument that the church-plan exemption violated the Establishment Clause, the court found that because plaintiffs failed to demonstrate "actual or imminent" harm, instead alleging "possible future injury," *e.g.,* the possibility for a future plan-funding shortfall, the plaintiffs lacked standing to assert their Establishment Clause argument.

Ultimately the court dismissed the complaint in its entirety, concluding that because ERISA did not apply and because the plaintiffs lacked standing to assert their constitutional argument, the court lacked subject-matter jurisdiction to hear the case.

In *Rollins v. Dignity Health,* 2018 U.S. Dist. LEXIS 152321 (N.D. Cal. Sept. 6, 2018), as in *Sheedy*, the court also considered these issues on a motion to dismiss and held plaintiff sufficiently alleged that the plan at issue was not a church plan: plaintiffs alleged that the defendant nonprofit healthcare corporation maintained the plan; thus, the defendant could not be a principal-purpose organization, and was not a church or association of churches.

An internal benefits committee administered the plan, but, according to plaintiffs, the committee did not "maintain" the plan. The court held these terms were not necessarily mutually exclusive, and distinguished between "maintain" and "administer." It appears from the decision that the defendant did not sufficiently argue whether or how the committee maintained the plan, and even if defendant had argued properly, the court clearly was strictly applying the standard of review on a motion to dismiss, as it should, and would not have considered any extrinsic evidence offered by the defendant, anyway. Further, the court distinguished the Tenth Circuit's *Medina* decision on the grounds that it was decided on a summary judgment motion, not on a motion to dismiss.

With respect to whether defendant was associated with a church, the court acknowledged the circuit split between the Fourth/Eighth Circuits and the Tenth Circuit. Plaintiff argued the court should apply the Fourth Circuit's *Lown* factors and the defendants argued the statute was sufficiently specific, as the Tenth Circuit found in *Medina* and the district court found in *Sanzone*, to address the associated-with-a-church issue. Nevertheless, however, the court stated that defendant "provided this Court with no test," so it appeared inclined to apply the *Lown* factors. Defendant referred to a significant amount of evidence in support of its position that it was associated with a church, *e.g.,* the defendant's website, its bylaws, and board membership, but the court did not consider it finding it would be improper to do so in deciding a motion to dismiss. Ultimately, the court concluded that plaintiff sufficiently alleged the plan was not a church plan and denied defendant's motion.

Smith v. OSF Healthcare System, 2018 U.S. Dist. LEXIS 168037 (S.D. Ill. Sept. 28, 2018), is another decision that considered the issues addressed by the Tenth Circuit in *Medina*.

The defendant in *Smith* was a nonprofit healthcare system. The Sisters of the Third Order of St. Francis (the "Sisters") founded the defendant. The Sisters are "an integral part of the Roman [Catholic] Church and … carry out its mission." The president and a majority of the defendant's board must be Sisters. All directors, including lay board members, are required to meet certain qualifications, including "Commitment to the Philosophy, Mission, Values and Vision of [the Sisters,]" and "Commitment to uphold the Catholic Code of Ethics in all dealings and deliberations pertaining to the Board's responsibilities." The defendant is recognized as a Catholic institution in the Official Catholic Directory.

The defendant established a defined benefit pension plan for its employees. An internal committee administered the plan.

Plaintiffs, two former employees of the defendant, sued claiming the church-plan exemption does not apply. They also argued the exemption is unconstitutional, because it violates the First Amendment's Establishment Clause. Defendant disagreed and moved for summary judgment.

Applying the Tenth Circuit's three-step inquiry in *Medina*, the court held the exemption applies and that it does not run afoul of the Establishment Clause.

The court first found that defendant is a nonprofit organization and that it is "associated with" a church as it "shares common religious bonds and convictions" with the Roman Catholic Church.

The court found that the internal committee is principal-purpose organizations in that its "principal purpose or function" is to administer or fund the plan for church employees.

The court also determined that the committees "maintain" the plan, even though they do not have the power to modify or terminate the plan, because under the plan, the

committee has the authority to adjudicate benefit claims, make benefit eligibility determinations, and to interpret the plan.

Finally, the court found that the committee is "tightly connected with the Roman Catholic Church." Indeed, it is "dominated by members of a recognized Roman Catholic religious order." To the extent the committee is an internal organization of the defendant, the committee shares defendant's Catholic affiliation.

Accordingly, the court concluded that the plan is a church plan exempt from ERISA.

Finally, using a similar analysis to the approach applied by the Tenth Circuit in *Medina*, the court applied the *Lemon* test to decide the constitutional question, discussed above, and rejected the plaintiffs' contention that the church plan exemption violates the First Amendment's Establishment Clause.

Conclusion

ERISA's church-plan exemption is hardly clear and the case law has been all over the map. Although the Supreme Court's recent *Advocate Health Care* decision sheds some light on how courts should be interpreting the poorly drafted principal-purpose organization language in 29 U.S.C. §1002(33)(C), the Court's unanswered questions stirred more confusion into the church-plan stew than it should have.

The Tenth Circuit seemed to address these issues rationally in *Medina*, but thus far it is the only circuit court to address the exemption head on since *Advocate Health Care*. As is typical when the Supreme Court leaves unanswered questions, the district courts are left mostly to thrash around in the abyss until more circuit courts provide guidance. *Medina* has grounded the district courts, a bit, but outside the Tenth Circuit, *Medina* is not binding precedent.

Because of all the newly sewn confusion around these issues, however, nonprofit corporations and their plans' administrators would be wise to retain outside counsel to guide them through the ever-deepening church-plan-exemption swamp.

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Fifth Circuit Approves Civil Penalties as Compensatory ERISA Remedy

By Aaron E. Pohlmann and Brendan H. White


In the wake of *Rochow v. Life Ins. Co. of Am.*, 780 F.3d 364 (6th Cir. 2015) (*en banc*), wise practitioners vigilantly stay abreast of developments in remedies available under ERISA.

In *Rochow*, the district court infamously awarded the plaintiff both benefits under Section 502(a)(1)(B) and disgorgement of profits of $3,797,867.92 under Section 502(a)(3), reasoning that the award of benefits compensated the plaintiff for an "arbitrary and capricious" benefit denial, and disgorgement prevented Life Insurance Company of North America from being "unjustly enriched" by an alleged breach of fiduciary duty and delay in paying benefits to which the plaintiff was entitled.

In an *en banc* decision, the majority of the Sixth Circuit reversed, holding that the plaintiff had an available equitable remedy under Section 502(a)(1)(B) for the denial of benefits, and therefore could not obtain additional relief for the same injury under Section 502(a)(3).

Hager v. DBG Partners

In a new case from the Fifth Circuit, *Hager v. DBG Partners, Inc.,* 903 F.3d 460 (5th Cir. 2018), the court held that civil penalties under Section 502(c) could be awarded to compensate a plaintiff for his medical expenses where

ERISA did not otherwise provide him with a remedy. In reaching this conclusion, the court relied on the language of Section 502(c) allowing a court, in its discretion, to award penalties "in the amount of up to $100 a day … and … *such other relief as it deems proper.*" 29 U.S.C. 1132(c)(1) (emphasis added).

Plaintiff Hager was enrolled in his employer's health plan, and in August 2014 he was fired. 903 F.3d at 463. He elected to continue coverage via COBRA, but his employer terminated the plan in May 2015. *Id.* Hager alleged that he did not receive notice of this cancellation and continued paying premiums through August 2015. *Id.* Ostensibly believing he was still covered by the plan, Hager underwent colon cancer treatment from June to August 2015. *Id.* Hager allegedly only learned that he was not covered after these treatments were completed. *Id.*

Hager brought suit against his employer in the District Court for the Northern District of Texas, seeking reimbursement for his accrued medical expenses from June to August 2015. *Id.* Hager maintained that he was entitled to this remedy because the employer violated COBRA by failing to notify him of the plan's termination. *Id.* Hager further argued that he was entitled to civil penalties provided under Section 502(c)(1). *Id.* at 470.

After a settlement conference proved unsuccessful, the district court expressed concern that, even if the employer did breach a notice obligation, ERISA only authorized equitable relief, and did not allow Hager to recover monetary damages. *Id.* at 464. In articulating this concern, the district court specifically highlighted the Ninth Circuit's decision in *Peralta v. Hispanic Business, Inc.*, 419 F.3d 1064 (9th Cir. 2005). *Id.*

At a subsequent hearing, the district court *sua sponte* dismissed Hager's COBRA claim with prejudice on the grounds that he did not have a viable remedy for this claim. *Id.* By doing so, the district court implicitly held that Hager also was not entitled to any civil penalty under Section 502(c)(1). *Id.* at 470.

Fifth Circuit Reverses

On appeal, the Fifth Circuit reversed the district court's decision to dismiss Hager's COBRA claim. *Id.* at 463. In doing so, the Fifth Circuit initially noted that the employer had a duty to provide Hager notice of the plan's cancellation pursuant to 29 C.F.R. §2590.606-4(d), and that a question of fact remained as to whether the employer adequately fulfilled this duty. *Id.* at 467. This determination was based on the fact that Hager's continued enrollment in the plan through COBRA occurred within 18 months of the "qualifying event" of the termination of his employment. *Id.* at 467. The employer insisted it had provided proper notice of the termination in a letter apparently sent to Hager's former address, but Hager maintained he did not receive the letter. The court determined that this disputed evidence presented a question of fact that was "more appropriate for summary judgment or trial." *Id.* at 468.

After determining Hager had stated a claim that the employer violated COBRA, the Fifth Circuit next addressed whether a remedy was available for this claim under ERISA's civil enforcement provisions. *Id.* at 468–71. The court closely analyzed whether a remedy was available under Sections 502(a)(1)(B), 502(a)(3), 502(a)(1)(A), and 502(c)(1). *Id.*

First, the court determined Section 502(a)(1)(B) did not provide a remedy because it only allows for recovery of benefits under an active ERISA plan. *Id.* at 469. The Fifth Circuit concluded that because the plan had been terminated a remedy under Section 502(a)(1)(B) was foreclosed. *Id.*

The Fifth Circuit next determined that Section 502(a)(3) did not provide a remedy because it only provides relief that is typically available in equity, which did not include "money damages." *Id.* at 469–70. The court acknowledged Hager's claim "could arguably be characterized as seeking restitution" under Section 502(a)(3)(B) even though "he ha[d] not characterized it as such." *Id.* But the Fifth Circuit determined that subsection (B) of Section 502(a)(3) did not provide a remedy because "restitution in the form of money is not equitable relief unless it was traditionally available in equity, such as a via constructive trust or equitable lien." *Id.*

The court concluded that "a remedy that only seeks to impose liability and require the defendant to pay the plaintiff a sum of money is a legal remedy, not an equitable one" that could fall within the ambit of Section 502(a)(3)(B). *Id.* at 469–70. The Fifth Circuit emphasized that Hager sought to recover medical expenses, and thus, his requested remedy constituted a claim for money out of the employer's general assets, which was not an "equitable" remedy. *Id.* at 470.

Expenses Awarded as Penalty

However, the Fifth Circuit ultimately held that Hager's medical expenses could be awarded as a penalty under Sections 502(a)(1)(A) and 502(c)(1). *Id.* at 471. The court initially noted that Section 502(a)(1)(A) "allows a participant or beneficiary to bring an action for the civil penalty

described in [Section 502](c)" and that Section 502(c)(1) "allows the court to award a discretionary penalty against an administrator that does not comply with the COBRA notice requirements of 29 U.S.C. §1166(a)(4),[] on which 29 C.F.R. §2950.606-4 elaborates." *Id.* at 470. Thus, the Fifth Circuit determined that Section 502(c)'s "civil penalty is available for failure to provide notice of the termination of the relevant health plan to a COBRA-covered former employee." *Id.*

In finding that a Section 502(c) civil penalty could encompass Hager's medical expenses, the Fifth Circuit noted that this subsection of ERISA articulates an available penalty "up to $100 a day from the date of such failure," and "such other relief as [the court] deems proper." *Id.* (quoting 29 U.S.C. §1132(c)(1)). The court also determined that the amount of this civil penalty award (*i.e.* the "other relief" available) "remain[s] discretionary." *Id.*

In deciding the amount of an award, however, the court clarified that district courts should consider factors such as "prejudice" to the party seeking such an award, as well as "the availability of other remedies." *Id.* at 470–71. The court emphasized that district courts should consider "the aim" of placing "the plaintiff in the same position [he] would have been in had full continuation coverage been provided, and to induce compliance by plan administrators" in formulating the amount of a penalty. *Id.* at 471 (internal quotations and citations omitted). Based on these factors, the Fifth Circuit stated that it could "discern no barrier to the court awarding the amount of [Mr.] Hager's medical expenses as a penalty" under §1132(c). *Id.*

The Fifth Circuit reversed the dismissal of Hager's COBRA claim and remanded to the district court to determine "the appropriateness of a penalty, and the amount of such penalty" under Section 502(c). *Id.* In doing so, the court articulated that these determinations "will require factual findings concerning [the employer's] good faith,[] [in providing notice of the plan's termination] which [was] disputed." *Id.*

Peralta v. Hispanic Business

In discussing the viability of the civil penalty in these circumstances, the Fifth Circuit noted that the Ninth Circuit also acknowledged its potential availability in *Peralta v. Hispanic Business, Inc.*, 419 F.3d 1064 (9th Cir. 2005), on which the district court's decision was based. *Id.* at 470. However, while *Peralta* involved a claim of failure to provide notice of cancellation of a group long term disability ("LTD") policy, the Ninth Circuit notably did not address whether "other relief" available under Section 502(c) could encompass a civil penalty for lost LTD benefits. *Peralta* is instructive as a contrast to *Hager*.

In *Peralta*, the plaintiff began working for defendant Hispanic Business, Inc. ("HBI"), a publisher of business magazines, in October 1998. 419 F.3d at 1067. In January 1999, HBI introduced a benefit plan providing LTD benefits under a new LTD policy. *Id.* Peralta was a beneficiary of the plan and covered by the policy. *Id.* However, in July 2000, HBI cancelled the policy, thereby terminating Peralta's LTD coverage. *Id.* HBI notified Peralta and its other employees of this cancellation by email on October 18, 2000. *Id.*

On October 10, 2000, eight days prior to receiving the cancellation email, Peralta was in an automobile accident and suffered serious injuries. *Id.* Peralta subsequently attempted to make a claim for LTD benefits, believing the policy was still in effect. *Id.* While in the hospital recovering from her injuries, Peralta learned that the policy had been cancelled. *Id.*

Peralta filed suit against HBI in the District Court for the Central District of California, claiming that HBI had breached its fiduciary duty under ERISA to provide adequate notice of the policy's cancellation. *Id.* at 1067–68. Peralta alleged that she did not purchase "outside insurance" after July 2000 because she believed she was covered by the policy. *Id.*

Based on this allegation, Peralta "sought either an order reinstating her LTD benefits, or, in the alternative, other orders that would provide substantive relief equivalent to the reinstatement of the LTD benefits." *Id.* at 1068. HBI moved for summary judgment, arguing, among other things, the cancellation email properly satisfied ERISA's notice requirement under 29 U.S.C. §1024(b)(1), which mandates that summary of a "modification" or "change" to an ERISA plan be furnished to its participants/beneficiaries within 210 days. *Id.* HBI further asserted that Peralta's request for reinstatement of LTD benefits or equivalent substantive relief would constitute money damages that are not recoverable "for a procedural ERISA breach." *Id.*

The district court granted summary judgment for HBI on the grounds that no remedy was available to Peralta under ERISA. *Id.* The district court found that because the policy was no longer in effect, Peralta's "requested relief must be compensatory in nature" and therefore was "outside the scope of the equitable enforcement mechanisms of ERISA 29 U.S.C. §1132(a)(3)." *Id.* The district court emphasized that under *Great-West Life & Insurance Co. v. Knudson*, 534 U.S. 204 (2002), Peralta could "not use the equitable enforcement mechanisms of ERISA to secure compensa-

tory relief for HBI's alleged breach of fiduciary duty." 419 F.3d at 1068.

Summary Judgment Affirmed

The Ninth Circuit affirmed. *Id.* at 1067. The court acknowledged that the cancellation email did not satisfy the fiduciary responsibilities ERISA imposes on plan administrators, but emphasized that the cancellation email's compliance with 29 U.S.C. §1024(b)(1) was not dispositive of the issue of HBI's fiduciary duties for two reasons. *Id.* at 1070–73.

First, the Ninth Circuit noted that ERISA places fiduciary duties upon plan administrators beyond "mere compliance with ERISA's express reporting and disclosure provisions." *Id.* at 1072. ERISA sets forth fiduciary obligations of plan administrators in 29 U.S.C. §§1101–14, which are separate and distinct from the reporting and disclosure requirements articulated in 29 U.S.C. §§1021–31. *Id.* Thus, a conclusion that satisfaction of a reporting or disclosure duty also satisfies the more general fiduciary obligations "would render the Act's fiduciary protections a nullity, or at least surplusage." *Id.* The court emphasized that prompt notice of a policy cancellation would fulfill "ERISA's purpose to safeguard the well-being of employees and apprise them of their rights under an ERISA plan." *Id.* at 1071.

Second, the Ninth Circuit concluded that the 210-day notice requirement articulated in 29 U.S.C. 1024(b)(1) did not apply to a "termination" of an ERISA plan. *Id.* at 1072. The court noted that Section 1024(b)(1) only applies to a "modification" or "change" to an ERISA plan, which merely alters the plan at issue while still keeping it intact. *Id.* Conversely, "the termination of a plan leaves an employee without any coverage whatsoever." *Id.* Thus, the court held that HBI did breach its fiduciary duty to Peralta because "while there is no express statutory requirement to notify participants in a timely fashion of plan cancellation, such a requirement is implicit in the structure and purpose of ERISA, and is more vital than the ordinary technical reporting and disclosure requirements." *Id.* at 1073. Nevertheless, the Ninth Circuit affirmed summary judgment in favor of HBI on the grounds that ERISA did not provide a remedy for this breach. *Id.* at 1073–76.

The court acknowledged that "limited remedies" for "technical procedural violations" of ERISA that "wreak[] substantial havoc" are available under Sections 502(a)(1)(A) and 502(c). *Id.* at 1073 n.13. Nevertheless, the Ninth Circuit determined that the "modest penalties" of $100 per day under Section 502(c) did not constitute "substantive remedies" encompassed by Peralta's request for relief. *Id.* The court did not discuss the "other relief" available under Section 502(c). Therefore, the Ninth Circuit analyzed Peralta's request for relief under Section 502(a)(3), based on the court's determination that Peralta actually sought "a monetary recovery from HBI equal to the LTD benefits that would have been available had the [P]lan not been cancelled" and "[o]nly §1132(a)(3) might permit such a recovery." *Id.*

The Ninth Circuit held that Section 502(a)(3) did not provide an available remedy, emphasizing that it only provides a substantive remedy of benefit payments when "an employer actively and deliberately misleads its employees to their detriment." *Id.* at 1075. The court cited *Varity Corp. v. Howe*, 516 U.S. 489 (1996), in which "the Supreme Court concluded that reinstatement into the former employer's plan (which had continued to provide benefits to other employees) was an appropriate equitable remedy under 29 U.S.C. §1132(a)(3) where employees were deprived of ERISA benefits through trickery." *Id.* at 1074.

The court also cited a previous Ninth Circuit case, *Blaue v. Del Monte Corp.*, 748 F.2d 1348 (9th Cir. 1984), which held that some procedural violations are "so egregious" they may "be equivalent to the arbitrary and capricious denial of benefits that entitles the claimant to substantive remedies under ERISA, *i.e.*, payment of benefits." *Id.* Based on these cases, the Ninth Circuit emphasized that "where fraud is involved, the courts will go to great lengths to find a vehicle for reinstatement of benefits via a §1132(a)(3) equitable remedy." *Id.* at 1075.

In *Peralta*, however, "[t]he evidence [was] simply of negligently inadequate communications about a policy cancellation." *Id.* at 1076. Accordingly, the Ninth Circuit determined that equity did not justify HBI being liable for monetary damages under Section 502(a)(3) because its misconduct did not rise to the level of "any intentional misleading or trickery, or of any active concealment." *Id.*

The court also concluded that Section 502(a)(3) does not allow money damages "for past harm," citing *Great-West*, in which the Supreme Court rejected the insurer's attempt to enforce the reimbursement provision of an ERISA plan against a plan participant "by means of the equitable enforcement mechanisms of §1132(a)(3)." *Id.* at 1075. As articulated by the Ninth Circuit, the Supreme Court rejected the insurer's claim by "distinguish[ing] between equitable claims that seek to prevent future losses, which are permissible under ERISA, and those that seek past due sums, which are not." *Id.* The Ninth Circuit thus held that Peralta's claim for monetary damages for past harm "as per *Great-West* is simply not available in equity" under Section 502(a)(3). *Id.* at 1076.

Conclusion

All of the grounds for rejecting claims for compensatory damages under Sections 502(a)(1)(B) and (a)(3) of ERISA set forth in *Hager* and *Peralta* remain valid points of argument. However, *Hager* opens a novel door to consider statutory penalties under Section 502(c)(1) as compensatory relief if a remedy is not otherwise available under ERISA. How the district court in *Hager* handles the issues on remand is worth monitoring for potential defenses to such claims in the future.

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ERISA Update

By Joseph M. Hamilton, ERISA Update Editor

First Circuit

In De Novo Benefits Case, District Court's Factual Findings Are Reviewed Only for Clear Error

In *Doe v. Harvard Pilgrim Health Care, Inc.*, 2018 WL 4237288 (1st Cir. 2018), the First Circuit joined several other circuits in holding that when a district court examines the denial of ERISA benefits under the *de novo* standard of review, the First Circuit would review the district court's factual findings only for clear error.

The underlying case involves coverage of residential mental health treatments. Doe is a dependent beneficiary in a group health benefit plan provided by Doe's father's employer. The plan was funded by a policy issued by Harvard Pilgrim. A dispute arose among the parties regarding the payment for a portion of the residential mental health treatment provided to Doe.

The district court had held in favor of Harvard Pilgrim and dismissed the complaint. *See* 2017 WL 54540961 (D. Mass. 2017). The district court also addressed Doe's attempt to expand the administrative record.

On appeal, the court first addressed the denial of Doe's request to expand the administrative record. The court found the district court erred in its determination for a variety of reasons, including the fact that submissions by the parties to the district court made clear that the parties were continuing to engage in an administrative review process after the date Harvard Pilgrim contended a final administrative decision had been made. Thus, the court held that the administrative record should have been supplemented with records propounded by Doe.

The court then turned to deciding the standard of review of the district court's decision denying benefits. Doe argued it should be *de novo*. Harvard Pilgrim argued it should be clear error.

Equating its role to reviewing an appeal from a bench trial, the court held that it would review the factual findings of the district court in the denial of an ERISA benefits claim *de novo*. While not specifically stated by the court, in all likelihood it would also conduct a *de novo* review if the benefit claim had been allowed by the district court and the appeal filed by the plan. In doing so, the First Circuit joined the Third, Sixth, and Ninth Circuits, which have employed a similar analysis.

This ruling will result in appeals of district court decisions in *de novo* benefit claims becoming much more challenging.

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