ROUNDTABLE DISCUSSION: RELIGIOUS ORGANIZATIONS FILING FOR BANKRUPTCY*

Mr. Samuel J. Gerdano: Good morning. Thank you all, first of all, for finding us, which I realize was a bit of a challenge because we weren't quite in the pocket brochure. Thanks to the Debtor-Creditor section, to Chris Frost, in particular, for graciously carving out some room for us to do this program, which we came upon after the initial plans for the committee meeting were in place.

Thanks also to members from the Law and Religion Section who may be with us today. We are happy that you can join us.

I want to invite members of the academic community to become members of the American Bankruptcy Institute [the ABI]. You always get a commercial when I'm up here. We have some membership materials in the back of the room. This is our membership brochure, and there's also a copy of our current *ABI Journal* for you to take.

We have about 135 active academic members in the ABI from A to Z, from Peter Alexander to Bob Zinman. And we'd be delighted if you could join us.

Today's program is going to be transcribed and will be the centerpiece of an upcoming issue of the *American Bankruptcy Institute Law Review*. The ABI's *Law Review* is published twice per year. The copy I have here was centered on the theme of our symposium that we did last October on the twenty-fifth anniversary of the enactment of the Bankruptcy Code.

We have an advisory board of about twenty-five or so academics chaired by Ray Warner from St. Johns. And we encourage you to think about joining the advisory board or writing for the *Law Review* at some point.

Ray is also very involved in another academic-oriented activity at ABI, and that is our National Bankruptcy Moot Court Competition, which is held each March at the Second Circuit in New York. This year the final round is on March 14th. It's that weekend. It is a terrific program. This year we have 40 law school teams competing, which is a record. The program has grown dramatically over the last dozen years or so and is a credit to Ray Warner and many others who have worked so hard on it, especially Bob Zinman, over the many years.

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* The roundtable discussion moderated by the Honorable Bruce A. Markell took place on January 7, 2005, at the 2005 Annual Meeting of the Association of American Law Schools, Section on Creditors' and Debtors' Rights, in San Francisco, CA. The panelists were Douglas Laycock, Jonathan Lipson, Nancy Peterman, Robin Phelan, and David Skeel. Samuel J. Gerdano provided a welcoming address. The Honorable Bruce A. Markell is a United States Bankruptcy Judge for the District of Nevada and a Senior Fellow in Commercial and Bankruptcy Law at the William S. Boyd School of Law, University of Nevada Las Vegas. Douglas Laycock occupies the Alice McKean Young Regents Chair in Law at the University of Texas. Jonathan Lipson is an Associate Professor at the University of Baltimore and a Visiting Associate Professor at Temple University. Nancy Peterman is an attorney at law and shareholder of Greenberg Traurig, LLP in Chicago, IL. Robin Phelan is an attorney at law and partner of Haynes & Boone in Dallas, TX. David Skeel is the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. Samuel J. Gerdano is an attorney at law and Executive Director of the American Bankruptcy Institute.

The description of this year's program is on our website, www.abiworld.org. You can click on the item on the homepage, which describes this year's competition as well as the problem. If you're at a school who hasn't participated, you should think about doing it. It's really a terrific event.

With that, let me introduce at least the moderator of the panel, who has been fully authorized to use the whip and chair on the unruly mob that he has to supervise the rest of the morning. He is Bruce Markell, who is not known to anybody in this group, but officially is the newest Bankruptcy Judge for the District of Nevada, having been sworn in last July.

(Applause.)

Judge Bruce A. Markell: You know that's not the reaction I get from the lawyers who appear before me.

(Applause.)

Mr. Gerdano: Is that a promotion, or how do we consider that? It's inside work and no heavy lifting involved.

Prior to that, of course, he was the Doris and Theodore Lee Professor of Law at the William S. Boyd School of Law at the University of Nevada, Las Vegas, where he taught all the usual suspect classes; he's also of counsel to the Los Angeles law firm of Stutman, Treister and Glatt.

Among his numerous accolades is that he's a conferee in the National Bankruptcy Conference; a member of the American Law Institute; a Fellow in the American College of Bankruptcy; a member of the International Insolvency Institute and the ABI; and a member of the Editorial Board of *Collier on Bankruptcy.* And he'll have much more time for all these extracurricular activities because he doesn't have much to do in his day job, I suppose.

We are delighted that Bruce was amenable when I called him to rope him in to doing this program.

Thanks very much to all the panelists. I will let Bruce introduce them at this point.

Thank you.

Judge Markell: Thank you, Sam.

A couple things before I get to the introduction of the panel and introduce what we're doing. First of all, I want to thank Sam Gerdano and Ray Warner, who were the primary movers in putting this panel together. They came up with the idea. They came up with the panelists. They did all the heavy lifting necessary to get it done. I want to extend a note of personal thanks to them for that.

With this panel it's sometimes difficult to get more than one sentence out at a time. But let me introduce the panel, and after I introduce the panel I will have some introductory remarks by way of background. Then we'll just let it go and kind of see where it came from.

I'll start the introductions at my left, your right. On my far left, which is an appropriate phrase, is Robin Phelan, the mad hatter of bankruptcy. Robin is a partner in Haynes and Boone in their Dallas office and is a frequent speaker with respect to bankruptcy topics, an innovative and challenging lawyer on all levels, and a person who writes a lot. And let me just tell you a few of his latest titles. You may want to steal them for your own articles: *Conflicts of Interest, Issues of Interest to Nobody but Lawyers, Judges, and Other Unstable People*; *Squeezing Blood from Turnips: Tax Issues in Bankruptcy Matters*;[1] and, my personal favorite, *What's the Difference between Barney the Dinosaur and Enron's Financial Statements and Other Mysteries of Broadband Trading.*

Robin has come up here not only because he lends a lot to any panel that he joins, but because he has experience in representing the Diocese of Dallas with respect to some of their earlier problems.

[Looking far left] As I said, the mad hatter.

Mr. Jonathan Lipson: Can the record note that?

Judge Markell: May the record reflect that Mr. Phelan has put a smiley face hat on his head and may it also reflect he's kept it there.

Again, it's hard to go from that to a serious introduction of Douglas Laycock, but I will try. The first sentence he gave me in his introduction indicates that he may be the only law professor in the country who has taught both religious liberty and secured credit.

He may have kind of left secured credit—I'm told by Jay Westbrook that he taught it for stretch of ten years at one point. But many of you may know of Doug from his writings with respect to remedies, which are topnotch.[2] In addition he has staked out a significant area with respect to religious liberty with various articles[3] and has actually taken an active role in cases by being counsel of record.

He's a graduate of the Michigan State University—go Spartans—and the University of Chicago Law School. He is a Fellow of the American Academy of Arts and Sciences and a member of the Council of the American Law Institute. And he currently is the Alice McKean Young Regents' Chair in Law at Texas.

Moving to my right is Jonathan Lipson, who is currently a visiting Associate Professor at Temple University. I'm not supposed to say it, but he's likely to stay. His home institution is the University of Baltimore where he is currently an Associate Professor of Law.

Jonathan had a long career in practice in various firms on the East Coast, but

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[1] Robin E. Phelan, Stephen M. Pezanosky, & Jennifer M. Graff, *Squeezing Blood From Turnips: Tax Issues in Bankruptcy Matters*, American Bankruptcy Institute Ninth Annual Southwest Bankruptcy Conference (Sept. 6–9, 2001), *available at* WL 090601 ABI-CLE 143.

[2] *See, e.g.*, DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES (3d ed., 2002); DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE (1991).

[3] *See, e.g.*, Douglas Laycock, *Theology Scholarships, the Pledge of Allegiance, and Religious Liberty: Avoiding the Extremes but Missing the Liberty*, 118 HARV. L. REV. 155 (2004).

has really come into his own since he joined the professoriat. He has written numerous articles with respect to the intersection of bankruptcy and corporate law as well as some previous articles with respect to the issues of religious liberty and fraudulent transfers, which I can commend you, as well as a sprinkling of things here and there in the *UCLA Law Review*, the *Minnesota Law Review*, and the *Wisconsin Law Review*.[4] He also works quite closely with the American Bar Association.

Moving on, Nancy Peterman is a shareholder in Greenberg Traurig, LLP in their Chicago office. I mentioned the fact that Douglas Laycock was a graduate of Michigan State because Nancy is a graduate of the University of Michigan.

Ms. Nancy Peterman: Two times, yes.

Judge Markell: Two times, yes. I am the son of two Michigan State graduates; that's why we're on this side and she's over there.

She chairs the reorganization group at Greenberg, Traurig's Chicago office.

Mr. Robin Phelan: Isn't Michigan the guys who couldn't figure out the quarterback was going to run?

(Laughter.)

Ms. Peterman: I have no comments on that. We have a few problems in sports.

Judge Markell: She has represented numerous clients of significant note and her firm represented many of the victims in the Boston Archdiocese settlement, so she brings that perspective to this panel.

Finally, "last but certainly not least," is always said and actually is appropriate here. David Skeel is the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. Why is someone who is a chair in corporate law here? Probably because David has written broadly, widely, and in a very interesting context on bankruptcy law and its history. His book, *Debt's Dominion*,[5] should be in each of your libraries, if not on each of your desks.

He's written a new book called *Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From*, Oxford University Press 2005. But he is also here because he has written about some of the issues that might be faced with a church filing for bankruptcy, most recently in the *Boston College*

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[4] *See* Jonathan C. Lipson, *Director's Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA. L. REV. 1189 (2003); Jonathan C. Lipson, *Financing Information Technologies: Fairness and Function*, 2001 WIS. L. REV. 1067 (2001); Jonathan C. Lipson, *First Principles and Fair Consideration: The Developing Clash Between the First Amendment and the Constructive Fraudulent Conveyance Laws*, 52 UNIV. MIAMI L. REV. 247 (1997); Jonathan C. Lipson, *On Balance: Religious Liberty and Third-Party Harms*, 84 MINN. L. REV. 589 (2000).

[5] DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

Law Review.[6]

If you listen to NPR, you'll hear him occasionally on that network, and he also writes occasional articles in the *Los Angeles Times*, *New York Times* and other papers. He covers the waterfront and brings his good skills to this panel.

Let me just give a short introduction about why the issue is here.

Mr. Phelan: Yeah, I was thinking about that.

Judge Markell: As you know, there have been three Catholic dioceses that have filed for bankruptcy within the last six months: Spokane, Portland, and Tucson. They are three of the 195 Catholic dioceses that exist in the United States. And they have all filed because of, I'm trying to pick neutral terms here, tort lawsuits with respect to the conduct of various priests ranging over a long period of time.

Looking at some of the court documents from the various places, let me just give you some numbers to try and put some perspective on some of the financial pressures faced by some of the dioceses.

In Tucson, for example, prior to their filing they had paid out $14 million in settlements to prior victims, with an average per-person settlement of some $764,000. These actions relate to the conduct of four priests over about a ten-year period.

The Diocese of Spokane at the time that it filed was facing eighteen lawsuits pending in state court, all of which were set to go to trial within six months of filing. They have been described publicly because the bankruptcy judge in Spokane actually had them do a status conference and made them disclose all outstanding litigation. In each of those cases there were an average of something between ten to fifteen lay witnesses, three to five experts, and a trial time of four to eight weeks.

The Archdiocese claims that these lawsuits account for fifty-eight individuals who have been abused, and that they know of seventy more. And, again, this is the result of the conduct of about four priests.

One of those priests, by the way, died in 1956. Many of these claims go back to the 1950s and 1960s. There are cases of very recent and very clear abuse, but some of the cases which are going to be dealt with in these bankruptcies present some fairly difficult issues of proof.

At any rate, that is kind of the background in terms of why, at least from a financial standpoint, some of these dioceses might think about filing.

I want to open up and just turn to David and say, with this kind of financial pressure facing the dioceses, what's wrong with filing for bankruptcy?

Professor David Skeel: I'm not sure how to pick up on that lead. I think I'm the guy who's supposed to say these cases should be kicked out on good faith grounds, which is not exactly what my position is, but—

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[6] *See* David A. Skeel, Jr., *Avoiding Moral Bankruptcy*, 44 B.C. L. REV. 1181 (2003).

Judge Markell: No, to be fair, I know that's not what your article says, but you raised the issue, so it is a fair question.

Professor Skeel: I raised the issue, and so what I'll do is I'll talk for a minute about the good faith question until Robin puts a hat on my head, at which point I'll stop talking.

The first question is whether a church can file for bankruptcy at all as a technical matter, or at least this was the question before the three dioceses filed. And it turns out the short answer to that is, pretty obviously, yes.

All of the dioceses that have filed so far are corporations sole, which is a corporate form that is available to churches and religious organizations. If you work through the requirements for filing a bankruptcy case, most "persons" can file for bankruptcy. As we all know and work through with our students, the definition of a "person" includes a "corporation" and a "corporation" is defined quite broadly so that it can include a corporation sole.

So as a technical matter it's quite clear that churches can file for bankruptcy, but a series of cases suggests that in some circumstances, even if you meet the technical requirements, you can be kicked out on good faith grounds. This is something that Bob Rasmussen knows a lot about, having written a completely successful brief about it in the Third Circuit.

Judge Markell: Which, by the way, you joined, right?

Professor Skeel: Which I joined and I still join. So now Bob is on my side, at least on this issue as the debates begin, perhaps.

The issue first kicked up in some of the really high profile cases in the 1980s. When Manville filed it wasn't clear that they were insolvent. Insolvency obviously isn't a requirement for filing for chapter 11, but there was some question as to whether they belonged in bankruptcy.

Continental filed for bankruptcy the first time to get rid of its collective bargaining agreement. Texaco filed because of litigation.

There was a lot of discussion in these cases about whether a case ought to be kicked out if it is filed simply for strategic reasons. What the emerging standard seems to be, at least in the Third Circuit, is whether there is a reorganizational purpose to the bankruptcy filing or whether it is purely for strategic purposes.

What does this mean? It's not entirely clear, but it is clear that what you don't want to do is say something like, "We are completely financially healthy. The only reason we're filing is we have a bunch of pesky litigants who won't leave us alone and we want to get rid of them," which is a paraphrase of what the corporation said in a case called *SGL Carbon*.[7] And the Third Circuit said there is no reorganizational purpose there. Therefore you don't belong in bankruptcy.

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[7] *In re* SGL Carbon Corp., 200 F.3d 154 (3d Cir. 1999).

A couple of things are interesting about the church cases. One is that in all of the cases a relatively discrete number of claims have been filed against them. We're going to be analogizing a lot, I think, to the mass tort cases. The church cases are like mass torts, but there's a much smaller number of claims. That's one thing that's interesting about them.

Another thing is there's almost no other debt. The only major debt is the claims of the clergy misconduct victims. And what that means is that in many respects these are two-party cases. These really are between the diocese and the victims. So there is a plausible argument—I don't think it's a winner—but there's a plausible argument that there is a good faith problem. This is really a two-party dispute. There are a discrete number of claims. There aren't thousands. They're usually in the tens or twenties or fifties.

So you could at least imagine a situation where a diocese said, 'We're only going in here because we're sick of these victims,' and a court might kick the case out on good faith grounds. I don't think it will happen. I do think these cases belong in bankruptcy, but it is a plausible issue.

One question that I have is why haven't we seen the good faith question fought out in these cases? In the three cases that have been filed so far, the victims and the diocese hate each other. There's a lot of animosity in these cases. And one of the puzzles, it seems to me, is why nobody is fighting about this. They're fighting about everything else. I may be wrong, but I don't think there has been a serious argument in any of the cases that they ought to be kicked out on good faith grounds.

Judge Markell: Well, let me ask Nancy that. As someone who has represented, or whose firm has represented, victims, do you think this is an argument you'd want to raise?

Ms. Peterman: It depends on the situation. For the claimants and the victims in these cases, the bankruptcy case provides a forum where they may easily discover what assets are owned by the dioceses. For example, the claimants can take advantage of the broad discovery afforded by a Rule 2004 examination.[8] And there are many other tools that can be used to gain information on the assets of the archdiocese, such as 341[9] meetings or examiners, in order to begin to structure a fair settlement for the abuse victims.

The other issue is that there are often a lot of plaintiffs' lawyers in these cases and each of them is trying to get the biggest piece of the pie. Some of them may be better at it than others.

If you are in bankruptcy, all of the plaintiffs' lawyers, as well as potentially a future claimants representative, will be forced to sit down and ultimately come to a resolution. They will figure out the pot of money and figure out how to divide it up.

If you represent an abuse victim whose case is close to trial, you may want to

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[8] *See* FED. R. BANKR. P. 2004.

[9] *See* 11 U.S.C. § 341 (2000).

avoid bankruptcy and instead get a judgment so that you can immediately pursue collection ahead of others. If a bankruptcy case were filed, you might want to immediately try to lift the automatic stay to have the trial and get a judgment, so that you are a liquidated claimant.

Mr. Phelan: Hey, Bruce. Here's what I think of that theory.

Judge Markell: Again, let the record reflect that Mr. Phelan is wearing a bonehead hat.

Mr. Phelan: Yeah. Because when you really get down to it, unless a diocese has a few tens or hundreds of millions of dollars lying around to pay the plaintiffs, you need to reorganize. And when you look at *SGL Carbon*, SGL Carbon was a subsidiary, one of many, many subsidiaries of, what, the largest graphite manufacturer in the world or pretty close thereto. And the CEO was dumb enough to say, 'You know, we have plenty of money. We have a great business. We're not in any financial distress at all, and we just filed this thing to get some leverage over these antitrust plaintiffs.' I think it was antitrust.

When you look at the Integrated Electronics case[10] they had no business, they were out of business. And they said, 'Oh, we just filed to put the cap on this real estate lease we wanted to get out of.'

So unless you have a pretty egregious set of circumstances like that, to me that kind of argument isn't going to fly. And in a diocese case the last thing these guys want to do is to file bankruptcy for the fun of it. They file because they're faced with this unmanageable set of claims against them.

Professor Lipson: Two questions, David. First, if these were analogous to mass tort cases, how would you then deal with all of the asbestos cases in Delaware, because they too would be two-party cases in many of the same respects?

And, second, what would the result be if they were kicked out of bankruptcy court; do you think that anybody gains economically by sending this all back to state courts where you have individual litigation (and where it may not be possible to certify these cases as class actions)?

Professor Skeel: Let me start off by letting the record reflect that I am not arguing these cases ought to be kicked out. In fact, the article that Bruce referred to earlier[11] was an article before these cases were filed saying bankruptcy may be appropriate in some of these cases, but—

Mr. Phelan: Yeah, but you've got to role play today.

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[10] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 384 F.3d 108 (3d Cir. 2004) (finding petition not filed in good faith).

[11] *See* Skeel, *supra* note 7.

Professor Skeel: But I do have a role, so I'll try to play it at least a little bit.

The difference from the asbestos cases is simply numbers. It's ten or twenty or fifty cases, not a thousand or 1500. And it's plausible the litigation system could deal with these claims.

I forget what the other issue was. I'm not sure if this is responding to it or not. If you're a bankruptcy court looking at this, I think you look at it from a financial perspective and ask whether the church seems to have enough assets to continue paying the claims as they arise and whether it is likely to be overwhelmed by them in the future.

And it's less clear to me with the church cases than with the mass tort cases that the litigation system can't handle this, although I again want to back up from my position and say there are some problems here. One of the advantages of using bankruptcy, even if there are a discrete number of cases, is that you can deal with the punitive damages issues and things of that sort.

So I do think bankruptcy offers some things that the litigation system doesn't do very well, but I also think it's a debatable question and it's not clear to me why nobody raised it—why somebody after these filings didn't make a fight out of the good faith issue.

Professor Lipson: I have two theories. One is the economic theory, which is simply that it's not in anybody's economic interest, in particular, the parishioners or the tort claimants, to be back out fighting individual fights in state courts where it's likely to be more expensive.

And, number two, the parishioners, who are the ones most likely to want to kick it out of bankruptcy, may think that they can get the benefit of the Religious Freedom Restoration Act[12] there and they couldn't necessarily get it in state court.

Mr. Phelan: Why would the parishioners want to kick it out of bankruptcy?

Professor Lipson: The parishioners want to kick it out of bankruptcy because they don't want the bankruptcy court to exercise its power to try to take what they might view as their property.

Ms. Peterman: The parishioners want a bankruptcy case so they can attempt to force much smaller settlements than outside of bankruptcy, by both avoiding paying any punitive damages, and establishing through a plan various tiers of claimants, as is done in the mass tort cases, where victims are forced into a particular tier and likely paid less than they would receive outside of bankruptcy.

Professor Lipson: So there are plenty of reasons why they don't raise it then.

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[12] 42 U.S.C. §§ 2000bb to 200bb-4 (2000); *see infra* text accompanying note 19.

Professor Laycock: And there are also plenty of reasons for it to be in bankruptcy. These are relatively small dioceses. They are being overwhelmed. There are not as many claims as in asbestos, but there are plenty enough to both be enormously burdensome to the church and for the claimants to get in each others' way and to be fighting over the shrinking pile of assets.

There are strong claims; there are weak claims; there are fraudulent claims. The later we get, the more claims look like the people who jumped on the wrecked CTA bus. And so there are those kinds of conflicts to be sorted out.

There's also a real marshalling of assets kind of problem. Because many of these claims are so old, there are many different insurance companies. The insurer in 1956 is not the insurer in 2005 and much of the insurance coverage has been exhausted.

And so both on the asset side and on the claims side there's a lot of coordination work that could be done in a bankruptcy court that cannot be done in state tort suits.

Judge Markell: Let me back up because you and the other panelists have touched on a key point, which is the assets. Typically one of our underlying assumptions is that liability ought to follow ownership of assets. And that one of the things that you reorganize is the ability to pay the claims from a restricted pool of assets. What are the assets here? Does anyone want to take that question on?

What are the assets that are going to be used to pay claims and why is this an issue in all these cases?

Mr. Phelan: Well, it's going to vary from diocese to diocese.

Judge Markell: And why is that?

Mr. Phelan: Because you've got an underlying thematic issue of whether the assets of the parishes constitute leviable assets, in essence, or assets of the chapter 11 debtor.

But beyond that you're going to find a different accumulation of assets in a place like Boston than you are in places like Tucson or Dallas. Older cities that have had large Catholic populations for a long, long time, are going to have—the accumulation of assets are going to be a different mix than you have in a place like Dallas.

Mr. Phelan: You may have a high school in a diocese. You may or may not have a hospital. You may have a chancery building. And there will be miscellaneous stuff.

Judge Markell: Just step back for a second and help me out. When you represented the Diocese of Dallas, how were assets held? One of the things you look at when you represent a judgment creditor is, 'I got to go after the assets that

my debtor holds.' How are these assets held? How do you figure out whose assets you levy upon?

Mr. Phelan: In a lot of different types of entities. Sometimes some of the assets are in a separate entity, a charitable foundation, nonprofit. Some of them are held by the Religious Orders, the Jesuits, or the sisters of whatever. Some of them are held in the name of the bishop.

We took the position that some of that property that was held in the name of the bishop was held, in essence, in trust. We basically applied trust law to it. So some of it was held in trust for the dioceses; some was held in trust for the parishes; some was held in trust for some of the other operations that were involved.

And we had real title issues because the title wasn't in very good shape in a lot of instances. We had a couple of pieces of property that was still in the name of Bishop Emiliano Gonzalez or something, who was the bishop of Galveston before Texas was the Republic of Texas, so we had to clean the title up on it.

But our position was that the bishop obviously doesn't own it for his own personal benefit; he's holding the trust for somebody else. And the question was sorting out who it was being held in trust for. Some for the parishes.

Judge Markell: And just to make clear, what's the legal consequence of saying that the bishop holds it in trust, from your perspective?

Mr. Phelan: It's not property of the estate under section 541.[13]

Ms. Peterman: And the claimants would be arguing the exact opposite—that it is property of the estate. Whether the parishes are unincorporated organizations, or some other entity, the claimants will argue that all of the assets are part of the corporation sole to be divided among the victims, or if the parishes actually happen to be different corporations, which is a possibility, then the claimants will look at alter ego claims and what control the diocese is exercising over those different parishes and assets.

Mr. Phelan: By the way, we didn't have a corporation sole issue in Dallas.

Professor Skeel: Well, what was the form of the diocese? There—it was not a corporation at all?

Mr. Phelan: We took a position it was either a common law corporation sole or another form of corporation under the Bankruptcy Code.

Professor Skeel: And how did you distinguish between property held in trust for the parish and property held for the diocese?

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[13] *See* 11 U.S.C. § 541 (2000).

Mr. Phelan: You have to go back and look at how it was acquired and who had acquired it. Under Canon Law the parishes are juridic persons, a separate entity. An accumulation of assets can be a juridic person. You had to go back and look and see who it was bought for, where the dollars came from.

Professor Lipson: I don't know if this is an appropriate point to bring this up, but one issue obviously is factual. It's difficult to figure out as a factual matter what property is held by the diocese and what property may be held by entities associated with it and what property may be held by parishioners who, in at least Canon Law terms and I think in common sense terms, are legally distinct from the diocese itself.

What I also wonder about is whether section 541 of the Bankruptcy Code applies at all. For example, the parishioners are probably going to say, 'Look, the Bankruptcy Code's rules on property of the estate don't apply here. And they don't apply here for either or both of two related reasons.'

First, you've got a long line of church property cases where the Supreme Court has said when you're dealing with a religious institution and its property, the ordinary rules about property don't necessarily apply. We give enormous deference to the church and its determinations about what it believes its property is and how to govern and distribute the property.

And so, while I'm not an expert in Canon Law by any means—I'm the Jewish guy on the panel, so I know nothing about this—but Canon 1292 basically says—

Judge Markell: But he'll quote it nonetheless.
(Laughter.)

Mr. Lipson: —you cannot dispose of what's called the 'stable patrimony' (the core assets) of the diocese without getting the authority of the Holy See, right? Well, if you're going to do a 363[14] sale—

Judge Markell: And for all us—

Professor Lipson: That's the Vatican.

Judge Markell: The Holy See is the Vatican?

Professor Lipson: Yeah.

Judge Markell: So some foreign power has to say—

Mr. Phelan: Right.

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[14] *See* 11 U.S.C. § 363 (2000).

Professor Lipson: The problem is that the property issues ultimately involve governance and if you believe that this long line of church property cases such as *Watson v. Jones*[15] and *Jones v. Wolf*[16] mean it when they say that courts can't interfere with internal church decisions about property, then you have to take seriously the church's own rules on what happens to this property.

And the church's own rules are very different in the Bankruptcy Code. In other words, *Lionel*[17] and section 363 may not provide the rule about the distribution of property. You don't need a reasonable purpose for selling assets according to the Vatican. We don't quite know what the rule is, but it appears to be different.

And the same basic issue comes up with respect to what comes into the estate in the first place. If the church has decided that the property really is property of the parishioners because they transferred it legally before bankruptcy and it's effective under Canon Law, I don't know that the Bankruptcy Code would necessarily apply.

The second and more powerful prong is the Religious Freedom Restoration Act (RFRA),[18] which was enacted in 1993 and says no federal law may substantially burden the exercise of religion unless it's supported by a compelling state interest. It sort of institutes the *Sherbert v. Verner*[19] test.

As you know, RFRA has been applied in the bankruptcy context. The *Young*[20] case from the Eighth Circuit said that, in effect, "thou shall not recover a fraudulent transfer it if was made by a religious debtor." Thus, tithes cannot be recovered if they were made for religious purpose, even if they're otherwise a fraudulent conveyance.

The parishioners can certainly say, "Look, if you can't take $3,000 in tithes away because that substantially burdens religious exercise, taking my whole church away to sell it to pay for the tort claimants is certainly going to burden my religious exercise."

Now I'm not necessarily advocating this position at all. I happen to take the tort claimants' positions very seriously. But I think it's an extraordinarily difficult problem, much more difficult than the ordinary mass tort case precisely because you have very compelling equities on both sides.

Ms. Peterman: Having to interject for the tort claimants, why would it be appropriate for a diocese to voluntarily choose to file a bankruptcy case and then decide to impose its own rules on what constitutes property of the estate? Here you are not trying to recover a charitable contribution made by an individual; rather you have a diocese that has chosen to take advantage of relief under the Bankruptcy Code and says "We've taken advantage of chapter 11 but, by the way, the rules as

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[15] 80 U.S. 679 (1872).

[16] 443 U.S. 595 (1979).

[17] *See, e.g.*, Comm. of Equity Sec. Holders v. Lionel Corp. *(In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (discussing extent to which section 363 permits a sale of an important asset of bankrupt's estate).

[18] 42 U.S.C. §§ 2000bb to 200bb-4 (2000).

[19] 374 U.S. 398 (1963).

[20] Christians v. Chrystal Evangelical Free Church (*In re* Young), 141 F.3d 854 (8th Cir. 1998).

far as property of the estate don't really apply to us. We have special rules."

Professor Lipson: I'm not sure that the diocese would necessarily say that. I'm saying that the parishioners are saying that, and they are distinct.

Mr. Phelan: Well, the parishioners have something to say about it, but they're not going to be the determinative factor there. You have to read Canon 1291 with Canon 1290, which is the one right in front of it.

Professor Skeel: He's just making these numbers up.
(Laughter.)

Mr. Phelan: And I do make things up. These are all farm cases; this is chapter 12.

Professor Laycock: He has a list of 207.

Mr. Phelan: I'm good at making things up, but this is one I'm not. 1290 says the general and particular provisions within the civil law in which a territory is established for contracts and the disposition are to be observed with the same effects in Canon Law.

It's a fact that both of them basically say you observe the civil law unless Canon Law provides something diametrically the opposite.

You have to read the patrimony section in the context of where it is, and it's under Title 3, contracts and especially alienation, Canons 1290 through 1298. They basically say, when you read them together, that you observe the civil law unless it's really going to screw up your religion.

To me if you just apply the trust concept, look at where the stuff came from, who paid for it and who's a juridic person; it's perfectly consistent with our civil law concepts and the Bankruptcy Code, section 541. So I don't see that there's any big conflict between the Canon Law and the civil law in the context of the chapter 11.

You can reconcile the two. And to the extent that Canon Law constitutes the law of a sovereign government, the Vatican, it seems to me that you have comity issues involved as well and you just need to reconcile the two systems. And I don't know if there's a big clash with the systems. Refer to the Canon involved, you don't even need to get into it.

Judge Markell: If I take your position to the extreme, that means that in an appropriate case the tort claimants could take the schools, the hospitals, and the church property and then let parishioners kind of go meet in the field if they want to worship? Is that your idea of what's going to be permitted by civil law?

Mr. Phelan: I think you can make that argument.

Professor Lipson: I think the question then comes down to what substantially burden means.

Mr. Phelan: Yeah.

Professor Lipson: And a court may well agree with Robin. I don't know what a court would do. Certainly the Eighth Circuit thinks that $3,000 is a substantial burden.

Judge Markell: Doug, what do you think on this?

Professor Laycock: I represented the church in the Eighth Circuit case. That was a much easier case for the churches than this one is. But there is a serious claim here.

The one of these cases I know the most about is Tucson. The details are going to vary from diocese to diocese, but I think the pattern illustrated in Tucson is going to be pretty common.

The parishes in Tucson are unincorporated associations. The property is held in the name of the bishop. There is no doubt that the parishes have been financially separate sub-entities operating on their own bottom. They've had to raise their own money; they've paid for their own building. They sometimes borrow from the diocese. They sometimes deposit money in what amounts to a diocesan bank, but the accounts have been kept separate.

Now there's going to be a very interesting question—whether they have ever cheated. Have they really kept this separate all the time, or does money slosh back and forth when somebody needs it? Generally, parishes are separate financial entities as far as their basic operating structure.

They have observed the formalities required by their own Canon Law. They may not have observed the formalities that the bankruptcy court would apply if we were talking about a secular corporation and its subsidiaries and affiliates.

If they've not dotted some secular "i" or crossed some secular "t" about proper formalities, do they get treated as all one pot of cash so that parishes that had nothing to do with this—that didn't pick the bishop, it wasn't their priest who was abusing anybody—lose their place of worship because of a negligent supervision claim against the bishop three bishops back or two bishops back?

There is, as Jonathan said a minute ago, a long body of law about deference to church choices of structure. That law is probably not as clear as Jonathan suggested. The Supreme Court has said that states have a choice between a couple of constitutionally permissible solutions. They can defer to the highest church authority that has passed on a question, which plainly protects religious liberty, or they said in a 1979 case called *Jones v. Wolf*,[21] state courts can apply neutral

[21] 443 U.S. 595 (1979).

principles of law to the documents that the church drafted. And the church can draft those documents to provide for what it wants to provide for.

Five justices thought that protected the churches because they could create whatever they wanted to create, but it has not worked very well in the ensuing twenty-five years and it doesn't work very well in part because there are a fair number of judges who will say what they have to say to reach the result.

Judge Markell: No.

Professor Laycock: I know you would never do that.

Judge Markell: No, no.

Professor Laycock: But, yes, we have a decision of the Supreme Court of Massachusetts,[22] for example, that says the Russian Orthodox Church is congregational, not hierarchical. If you can believe that, I have a bridge I want to sell you.

But also because these documents get read from a wholly secular perspective, an entirely secular perspective—no pun intended—with the religious understanding that went into the documents being left out.

Now Protestant churches have also had a problem with sexual misconduct. It hasn't gotten nearly as much publicity. There are plenty of Protestant cases. If this were a group of Baptist churches there would be absolutely no doubt. Every church is on its own bottom financially and theologically. And the First Baptist Church in Tucson would not lose its place of worship because somebody made a huge mistake and incurred a huge liability over in Tempe or Phoenix.

There is a serious problem if we apply this law and we get radically different results for different churches and different choices of church organization. A scandal like this becomes utterly destructive of Catholicism in the United States and not of Protestantism in the United States without regard to differences in the culpability of the conduct.

Judge Markell: Why is that?

Professor Laycock: Because the choice of religious structure is a constitutionally protected choice and—

Judge Markell: And so they choose a structure that exposes them. Why should they not then bear the risk of that?

Professor Laycock: As a pure matter of Free Exercise they may well bear the

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[22] Primate & Bishops' Synod of the Russian Orthodox Church Outside Russ. v. Russian Orthodox Church of the Holy Resurrection, Inc., 636 N.E.2d 211 (Mass. 1994).

risk of that, because the current Free Exercise standard is simply that if you've got a generally applicable law, you apply it to churches.

But, as a matter of the Religious Freedom Restoration Act, we impose a substantial burden on this choice of church organization and church policy if we're going to read this form of organization in a wholly secular way without regard to the religious understanding that informed it and without regard to how it actually operated over the years. If it turns out these parishes really were each operating on their own financial bottom with a separate pot of money and we're going to override that because they failed to conform to secular technicalities that would have been required in the secular world, I think that is a serious Religious Freedom Restoration Act issue.

Professor Lipson: Let me just respond quickly to what Doug said about the church property cases. I agree that they're very, very complicated.

Professor Laycock: These are internal cases. These victims were members of the church who subscribed to its form of religious organization. Courts refuse to view it that way. They've treated all these people as though they were outsiders who had nothing to do with the church and were not bound by anything going on inside it.

Professor Lipson: Right. And my instinct is to believe that a court today might say, 'You might have been a member of the church; you might have been sent there by your parents to go to school, but you're not a member of the church for purposes of being victimized in this way.' It doesn't really make a lot of sense.

So I don't know that the church property cases should be nearly as persuasive in this context if I'm a parishioner as RFRA, the Religious Freedom Restoration Act, which is powerful.

The tort claimants would then respond by saying: 'Well, wait a minute. RFRA only disables federal law, right? See *Boerne v. Flores*.'[23] Professor Laycock can talk about it better than I can. He litigated it. But while RFRA does disable competing federal law, *i.e.*, the Bankruptcy Code, it doesn't disable competing state law.[24]

Well, where does property come from in bankruptcy? *Butner*[25] says that property in a bankruptcy case is principally an issue of state law unless some other compelling federal interest asks you to look to some other source.

So one response for the claimants might be well, RFRA just doesn't matter. The property of the estate is going to be determined, as Robin suggests, by

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[23] City of Boerne v. Flores, 521 U.S. 507 (1997).

[24] Professor Laycock belatedly notes that Arizona has its own Religious Freedom Restoration Act. Ariz. Rev. Stat. Ann. §§ 41-1493–41-1493.02 (West 2004). Washington's Free Exercise Clause requires that burdens on religious exercise serve a compelling interest by the least restrictive means. First Covenant Church of Seattle v. City of Seattle, 840 P.2d 174 (Wash. 1992).

[25] Butner v. United States, 440 U.S. 48 (1979).

charitable trust law or by other ordinary principles of state property law that we're all very familiar with in the bankruptcy context.

So, my bottom line, the only message you should take away, is I think we have to take the parishioners' claims seriously because even if bankruptcy courts want to do exactly what Robin wants to do, and I think many people to do, there's likely to be a U.S. Court of Appeals somewhere that's going to say 'well, you have to look at what the statute [RFRA] says and you have to look at the larger constitutional issues.'

Judge Markell: Right now it's Ninth Circuit, right? All three of these dioceses are in the Ninth Circuit.

Professor Lipson: The Ninth Circuit had the *Thomas*[26] opinion. Although they reversed themselves later, they said, 'Look, if you're a religious landlord, you can discriminate against your tenants notwithstanding a statutory prohibition on discrimination on religious grounds.' And they rethought it and that was probably the right result. But who knows what a Court of Appeals is going to do with this?

And, so, my only message to you is: I don't think it's as simple as saying, 'well, it's just bankruptcy, so who cares.'

Mr. Phelan: Hey, Jon, do you make a distinction as Bruce did between a chancery building, which is just an office building, and the hospital, or the school?

Judge Markell: Let the record reflect that Mr. Phelan is now wearing a hat that looks like an office building if you look at it right.

Mr. Phelan: If you try real hard.

Professor Lipson: I thought it looked like a windmill.

Mr. Phelan: I didn't have a church steeple, but it's close.

Anyway, do you make a distinction between what could be arguably described as commercial property and something like a school?

Professor Lipson: I do. I think that's a really excellent question because it goes to the 'substantial burden' piece of the formulation.

Professor Skeel: I just want to throw something in that will sound different but is I think really on that same point. If you take Doug's position, I think you really cloud real estate title. If you take the position that churches can effectively ignore

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[26] Thomas v. Anchorage Equal Rights Comm'n, 165 F.3d 692 (9th Cir. 1999), *vacated on other grounds*, 220 F.3d 1134 (9th Cir. 2000) (en banc). The *en banc* court vacated the decision and dismissed the action for lack of ripeness. Thomas v. Anchorage Equal Rights Comm'n, 220 F.3d 1134, 1142 (2000) (en banc).

the secular real estate law in circumstances where it's very easy to set things up the way you want them so that it's clear that parishes own the property, not the diocese, you really cloud things up.

My inclination would be to insist that you use the real estate records the way everybody else does. And if there is not anything in the deed that suggests that this property that's in the name of the bishop and the diocese is held in trust for somebody else, I would be inclined to honor the legal title.

I guess I'm a little more sympathetic to *Jones v. Wolf*[27] than other folks seem to be.

Mr. Phelan: It seems to me that you get—and truly not to make a pun of it—but you really should have an academic issue on that at this point in time, because if a bishop doesn't have his real estate title in appropriate form by now, he ought to get transferred to a mission in Borneo or somewhere.

Professor Laycock: Hey, if they knew how to run this organization they wouldn't be in this trouble.

Judge Markell: You could say that about almost every debtor.

Mr. Phelan: We did the Dallas drill in '97 and '98 and they talk to each other. If a diocese doesn't have its real estate title or its property titles in decent shape by now, they really are dumb.

Judge Markell: Let me make two points on that. One is a factual point. The Tucson plan of reorganization does just that. Post-confirmation it transfers all the individual property to individual corporations that will constitute each parish.

Let me take your point on substantively. Haven't you just raised a whole bunch of fraudulent transfer issues then?

Mr. Phelan: Not necessarily. You have if you're transferring stuff. You're not if you're clarifying title so it reflects what actually is the situation.

Professor Laycock: Right. But if you're really only clarifying the title you ought to win whether you've clarified it or not.

Mr. Phelan: Correct, it's just harder.

Professor Laycock: Yeah. Plainly harder.

Let me say one other thing about the underlying basis of these claims that relates directly to these choices about property. There's no doubt that the molesting priest is liable. He doesn't have a First Amendment defense, but he also doesn't

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[27] 443 U.S. 595 (1979); *see supra* text accompanying note 22.

have any money usually, so they're not suing him.

At least most state courts—I think nearly all state courts—have rejected *respondeat superior* claims, because he's clearly not operating for the benefit of his employer. So the parish is not liable as *respondeat superior*. The bishop is not liable as *respondeat superior.*

The claims that have succeeded are against the bishop for negligent supervision, for reassigning after he should have known better, and so on and so forth. So the claim runs only against the bishop and the diocese itself.

Now at least in Tucson, and I think this would be fairly common, the property that the bishop holds that he says is for the diocese, not for the benefit of any particular school, or parish, or hospital, or whatever—it's the corporate headquarters. There's hardly anything there.

So while from the parishioners' perspective there's absolutely no doubt their property is money they and their predecessors raised for local purposes and their local parish, there is a sort of too-good-to-be-true aspect if the bishop who is held liable or the negligent guy who is held liable doesn't own very much for the benefit of his entity.

Professor Lipson: I just want to go back Nancy's point. Nancy had asked why a diocese would file for bankruptcy relief and then claim not to be governed by the rules that it has sought to avail itself of.

I think this is the way that might work: the bishop may say 'of course we're subject to Bankruptcy Code's rules and the Bankruptcy Code says we can have this plan, and this plan will have $50 million worth of assets and we're going to distribute them in the following way.'

The parishioners, however, may say, 'Well, no, wait a minute. Twenty-five of those fifty million came from us and if you sell the assets then you will destroy our ability to worship.' So the conflict would come that way. It's not because the diocese itself would want to have it both ways.

Ms. Peterman: You actually end up with a property of the estate issue between the claimants and the diocese and then also with the parishioners. The parishioners are not technically creditors so do they even have standing to be coming into bankruptcy court and making any argument?

Professor Laycock: Well, if they claim they're the beneficial owner of the property.

Ms. Peterman: The Tucson plan, as currently proposed, suggests that there is about $3 million worth of assets that the diocese has to satisfy the tort claimants.

The plan also has a class of parishes. Pre-bankruptcy, some of the parishes apparently had contributed money in order to settle the claims.

Now that Tucson has filed a bankruptcy case, they are saying that there are only

$3 million of assets owned by the diocese and none of the parish assets are included.

So you get back to the argument that you can't have it both ways. From the claimants' perspective, when the diocese chooses to take advantage of bankruptcy, the claimants should be dealt with fairly, told what assets exist, how the entity is set up, and how the money was managed in order to reach a fair result and settlement between the tort claimants and the religious institution.

Mr. Phelan: What they're doing in Tucson is the same thing we did in Dallas. From a transparency standpoint, we went and got an accounting firm that was recognized in any bankruptcy arena as being credible. We had them look at the assets, and we were pretty transparent with the plaintiffs. They're doing the same thing in Tucson.

As I understand the plan, the parishes that want to be covered by the injunction that's part of the plan will be contributing some extra dollars just to eliminate the issue, it's a get it behind them kind of thing, so that they can participate in the plan and be covered by the injunction, or if they don't participate in the plan they're not going to get covered by the injunction.

So it's pretty consistent with some fairly standard bankruptcy concepts that you can't discharge a third party, but if a third party's throwing the money in sometimes they can be covered by an injunction.

Ms. Peterman: The plan also deals with the insurance companies and offers them the injunction in exchange for a contribution. At least in a mass tort case, the prospect of an injunction often brings an insurance company to the table willing to put in the cash in exchange for a channeling injunction that prevents anyone pursuing them in the future.

Mr. Phelan: And some of the mass tort cases do have a similar type of provision where you kick dollars in and the parties that check the box and take the extra dollars are going to be bound by the injunction.

Professor Lipson: Can I throw something out for discussion? I'd like to get your thoughts on it. If courts do want to take the parishioners' position seriously and want to some extent to be able to avoid the really significant doctrinal mess that these competing systems (the religious liberty and bankruptcy systems) create, is there some special role for equity? I'm well aware of *Grupo Mexicano*,[28] but I wonder if there's a constitutional sense in which we think about equity.

I mean, for example, *Brown v. Board*[29] was an equity case. When you've got these profoundly important issues in the Constitution and irreconcilable problems,

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[28] Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999) (holding scope of federal equity jurisdiction extends only as far as traditional English courts of equity).

[29] Brown v. Bd. of Educ., 347 U.S. 483 (1954).

maybe you need to give bankruptcy courts the power to craft special remedies like the ones you're describing.

So, for example, you might say to the parishioners, "Well, you're losing a lot of stuff, but you'll get a license back to use the church. You're not going to be treated as a creditor because you're not a creditor. You don't have any status in the case at all, but we're going to recognize that you have some continued right of use that you wouldn't otherwise be entitled to as a matter of bankruptcy law."

Mr. Phelan: Didn't you ever read that Italian dude on the Supreme Court who says when you have a statute you have to read it?

Professor Lipson: As I said, I'm cognizant of—
(Laughter.)

Professor Lipson: —*Grupo Mexicano*.

Mr. Phelan: I was thinking more of the bankruptcy—105[30] is not a roving commission to do equity. Sure, it's a court of equity. You can't rewrite the statute. There are priority provisions in the statute. It's either property of the estate or it's not.

I don't think you can say, "Well, I think it ought to be property of the estate, but it's going to hurt too many people, so therefore I'm going to give some of it back or I'm going to craft some remedy."

I don't know about that.

Judge Markell: Isn't there a sense in which the parishes themselves want this issue decided?

Mr. Phelan: Sure.

Judge Markell: Because if, in fact, you go through and don't decide the issue, someone could say afterwards, "I don't care what the bankruptcy court said. I think that the property is still property that is available to satisfy my tort claim."

So don't the parishes want some determination in some way so that they can get the benefit of bankruptcy and finally resolve this issue?

Professor Lipson: Right, but if everybody agrees, then it's easy. My only response to Robin is that the Italian guy on the Court also wrote *Bush v. Gore*[31] and is Catholic, so who knows what he would do with this.

Mr. Phelan: Yeah, that's what I'm saying.

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[30] *See* 11 U.S.C. § 105 (2000).
[31] 531 U.S. 98 (2000).

Professor Lipson: He's a religious Catholic, so he might—

Professor Laycock: He's very seriously religious, but that doesn't mean he believes in religious liberty. He also wrote the opinion that tried to repeal the Free Exercise Clause.[32]

Mr. Phelan: Right.

Professor Laycock: But there is room for bargaining here. The problem is that there are lots of parties; there's always that kind of difficulty to bargaining in bankruptcy. Also, some of the lawyers representing the plaintiffs wish to use these cases at least to completely restructure the Catholic Church and reform it in their image. That's the least of their ambition, because some of them would really like to destroy it. So that's an obstacle to bargaining.

But all these legal uncertainties obviously create room to bargain. The plaintiffs' lawyers can threaten to take away all of the parish churches. The parishioners can threaten to take away the stream of income. They don't have to keep giving.

Mr. Phelan: Absolutely.

Ms. Peterman: Right.

Professor Laycock: Right. The income to a nonprofit doesn't come from selling goods and services. It comes from people voluntarily sending in money they don't have to send.

So there's an obvious deal to be done. You keep contributing to fund the plan and we won't take away your church.

There's plenty of room for settlements that are reasonably fair to both sides. Whether they can get there, given the hostilities that have arisen in these cases, is a much harder question.

Judge Markell: Let me just use that as a springboard to another, but related, issue, which is how do you get there? We all know and many of us have studied the pressures that exist in a bankruptcy to bring people to a deal.

Douglas Baird has the famous example that analogizes bankruptcy to the bargaining over a dish of ice cream. The point of that example is that whoever can cut the deal sooner is better off because, if you bargain too long, all you have is a mass of goo.

Is there something similar, here? What are the case problems? I give you an

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[32] Employment Div. v. Smith, 494 U.S. 872 (1990) (holding Free Exercise Clause not applicable when laws are not aimed at promoting or restricting religious beliefs).

example. We all know about first day orders. In the Spokane case there was a request for a first day order to pay employees their accrued wages.

There was an objection from some tort victims or people who represented tort victims saying that doesn't go far enough. That only covers those people who are employed directly by the diocese. We think all the employees of the parishes ought to be covered as well, since parish property is really diocean property, and thus you can't do the order. And thus try to bring the property issue in on the first day.

What kind of things could you expect in a bankruptcy case, and what kind of things should you avoid? What are the tools in the bankruptcy practitioner's toolkit that allow you to get to the settlement that Doug thinks is there?

Ms. Peterman: If you end up in one of these cases and you are arguing all of these constitutional issues, the case is going to go nowhere and very quickly fail. The legal fees alone would be just astronomical.

Judge Markell: As a background to that, in Portland the legal fees are apparently running somewhere between $200,000 and $300,000 a month.

Ms. Peterman: The diocese is paying debtor's counsel and presumably committee counsel and whoever else is entitled to be paid. In the Spokane case, the court endorsed a case management order that debtor's counsel would be paid $200 an hour, so whoever was going to represent the committee should not be paid more than $200 an hour either. They knew that there were some practitioners out there at $500 an hour rates, and they wanted those people excluded from representing the committee unless they reduced their hourly rate.

In these cases the claimants need to know the available assets, whether the assets are owned by the diocese and what insurance policies are available. Then you need to get a sense of value of the claims.

Presumably, the claims will well exceed the value of the assets. In the Portland case, the judge has ordered a mandatory mediation. So, the judge is forcing people to sit down and talk. In Boston, a mediator was also brought in to help the parties reach an agreement. If people sit down, start understanding the realities and are forced to hear the different sides of the argument, people likely will come to the table and make a deal.

As a bankruptcy lawyer, I always assume everything can settle, but these cases obviously involve a lot of emotions.

Professor Lipson: Nancy, if Robin is now a strict constructionist, where in the Bankruptcy Code does it provide for mandatory mediation?

Ms. Peterman: Not anywhere that I know of. In another non-religious case that I am involved in, we tried to get a mandatory mediation process in place to deal with preference cases, and the judge would not order mandatory mediation—only

optional.

Judge Markell: What types of things could you expect in these cases? The statistics I tried to get from Spokane showed that they're going to face some litigation no matter what.

Mr. Phelan: Well, it depends. You do your homework ahead of time, Bruce. What you do is you get your title in good shape. You have the title say, "Held by Bishop Garbanzo for the benefit of St. Monica Parish" or "for the benefit of the Hispanic Outreach Center" or whatever it might be. It happened to be one we had in Dallas.

You have your title in good shape. You scrupulously look at where the dollars came from. I think, as somebody indicated earlier, these churches and the parishes are built with parishioners' money generally. They're not built with diocese money as a general rule. You have that.

You establish credibility by being transparent with respect to what your assets are. And there are going to be some gray area assets that you're going to be arguing about, but hopefully you've got transparency there.

You have thought out what your plan's going to look like, like they did in Tucson. You put it on the table early and you sit down and you really negotiate. And you be prepared, if you have to, to throw them the keys.

Judge Markell: Now would you explain what 'throw them the keys' means?

Mr. Phelan: I wouldn't throw them the keys to the parish.

Ms. Peterman: You would throw them to the tort claimants and they probably would not want the assets. It depends on the value.

Mr. Phelan: I'll tell you, I'll go to the mat on the parish stuff. But the chancery building, the raw land that was going to be for the new parish, the whatever it is piece of real estate that grandma gave when she died to the diocese.

Boston had piles of that kind of stuff. The Garbanzo mansion they used for retreats. That was Providence, I think. But some of these parishes have all kinds of miscellaneous goofball assets that were given to them by somebody when they died, and they use them for whatever.

There was a shopping center that we had in Dallas that some of them had converted into a store. They were going to use it for a school eventually, and there were a few things like that.

You add it up and you sit down with the plaintiffs and say, "Here's what we have. Now let's sit down. This is what you're going to get." Because, as I think Jon indicated, the parish parishioners aren't going to pay any more money. They're not going to put the dollars in to go fund this stuff unless it's a reasonable number and

they can see a light at the end of the tunnel.

Mr. Phelan: You've got to convince the bishop to be prepared.

Judge Markell: Let me ask this question. Let's say you do all that and you're met with the type of resistance that Doug has described. Do you consent to the appointment of an examiner to try and resolve credibility issues?

Mr. Phelan: If it comes to that, I'd seriously consider it. You try to head that off. You don't want that because it's another layer of expense. It's another layer of complication. It's going to prolong the situation. But if that's what it's going to take to get a deal done or if that's what it's going to take to get your plan through to establish that you have in fact disclosed all the assets, then you may have to consider that.

Professor Lipson: Then you may get into some of the other religious liberty issues like autonomy. For example, does the church have legitimate reasons for not wanting an examiner to poke around in lots of things? Is there some special limit that religious liberty law might put on the examiner?

Mr. Phelan: The special limit is, "Bishop, get over that."

Professor Laycock: Yeah.

Mr. Phelan: You're going to have to do it if you want to get out of this mess. And that's where the parishioners are going to come in. The parishioners are going to be banging on his door. And I don't think the parishioners have a particular standing in the case of the diocese. But as a practical matter the parishioners are the ones who exert influence at the parish level. If the parish is claiming my property's mine and you're claiming it's the estate's, it does have, as Doug indicated, the standing to assert that position. But the parishioners are the ones who are going to be banging on the bishop to stop being stupid.

Professor Lipson: No, I don't think it would be the bishop who would oppose.

Ms. Peterman: From a practical standpoint in bankruptcy, if you are the first to strike you're always in the best position.

Ms. Peterman: As a debtor, you do not want claimant's counsel asking for an examiner because the claimants will ask for the examiner to be vested with broad powers. If debtor's counsel asks for the appointment of an examiner for a limited purpose, this may prevent the broader relief requested by the claimants. It will take some convincing with your client.

Mr. Phelan: Yeah. We circumvented that by hiring an accounting firm that everybody knew. And I think in Tucson they got the same kind of deal. The players know each other. I know the guys that are handling the Tucson from the debtor side, the committee side, and the parish side. And they're all three really good bankruptcy lawyers. And they know each other and they know which accounting firms they can rely on.

Professor Laycock: I don't think there's a serious religious liberty problem with an examiner.

Obviously there are serious problems about the scope of authority of any trustee, but we don't appoint trustees very often anymore. So that's probably not an issue.

And your trivia find for the day, one court has held you cannot appoint a receiver for a religious organization. I think that's called *Heitkamp v. Family Life Services*[33] in the Supreme Court of North Dakota, a religious credit counseling agency went down the tubes. But an examiner would not run the entity; he would only gather information.

I think you're only dealing at the margin with possible privilege or confidentiality issues. And the stuff he's interested in shouldn't trigger those, as far as I can tell.

Professor Skeel: Can I introduce another set of issues that bears on the question of whether we get to a deal or not? In an ordinary chapter 11 there are a couple of provisions that can help prod the parties along.

There's the possibility of converting to chapter 7 if the debtor doesn't put a plan together. There's a possibility of losing exclusivity. On the other side, there's the possibility of cramdown. If a class objects, the debtor can try to use cramdown.

In the church bankruptcies, the liquidation option is gone. With a nonprofit corporation you can't convert against their wishes to chapter 7, so that stick is gone.

A really interesting question, it seems to me here, is what about cramdown? Could a diocese, if they reach impasse in the negotiations, propose a cramdown plan? It seems to me that that's really up in the air.

There are some courts in a couple of nonprofit contexts involving hospitals and utilities that have said cramdown works differently with nonprofits. Nonprofits don't have real shareholders, so the fact that the victims or the other creditors aren't getting paid in full is not preclusive.

It seems to me this is potentially a really critical issue in these cases if the animosity continues. Can the diocese propose a cramdown plan and, if they do, what happens?

Mr. Phelan: The answer is yes it gets confirmed.

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[33] State ex rel. Heitkamp v. Family Life Servs., Inc., 616 N.W.2d 826 (N.D. 2000).

Judge Markell: It would be the victims, right, who would be proposing the cramdown plan?

Professor Skeel: No, it would be the diocese.

Professor Lipson: They're cramming down against the parishioners.

Ms. Peterman: The claimants will likely not want the keys to the diocese's property.

Judge Markell: We don't want their keys.

Professor Skeel: And they'd say this is our last, best offer. Here is what we're giving you.

Mr. Phelan: We were ready to go there. If we had to, we would propose a cramdown plan. We would find an affirmative assenting class. The car dealer that has the lien on the trucks that we use to keep the grounds, on the lawnmower, and we would go in and say, 'These are the assets. This is what they're going to get. This is the remaining enterprise value. This is it.' No one below them is getting anything. Obviously they're not entitled to get anything, and so therefore confirm the plan.

Ms. Peterman: The debtor may then lose its ability to get a channeling injunction because you're supposed to have a plan overwhelmingly accepted by the creditors in order to obtain a channeling injunction.

Ms. Peterman: The debtor may only be able to deal with its known claimants and deal with the unknown claimants post-bankruptcy.

Mr. Phelan: I can do a voluntary waiver kind of plan where you check the box and you waive your claim for some extra dollars that are put in by somebody else.

Ms. Peterman: Right.

Judge Markell: Actually what I was thinking about was David's second point, which is loss of exclusivity leading to competing plans.

Judge Markell: And that strikes me to be really mind-boggling in the sense that you would probably have two plans that would have completely different senses of what property is at issue.

Professor Skeel: A very important article written about fifteen years ago in the *Stanford Law Review* considered those kinds of possibilities.[34]

Judge Markell: Be that as it may. There will be a footnote in the transcript as to what he's referring to, but the—

Mr. Phelan: Define "important."
(Laughter.)

Professor Skeel: The moderator is our definition.

Judge Markell: I was going to say a panel member wrote it; that's the definition at this point.

Now I think some of the RFRA restrictions become very interesting with respect to proposing a competing plan. There are some core things with respect to a church or any religious institution that you simply can't touch in a plan. And does it make sense to even propose a plan if they are so linked to revenue or assets that you just can't think of a competing plan other than a liquidation plan?

Professor Lipson: The way I analogize RFRA in these cases is that it is like a floating lien of sorts. It just floats over these cases in a weird way. And it picks up some things and may have significant consequences for some aspects of the case, especially the more governance related aspects. And so you end up with these very strange strategic possibilities, but I think you're absolutely right. Can you replace management?

Judge Markell: Once you're in bankruptcy, once in fact a diocese is in bankruptcy, what's the best result for the victims, even those victims who want to destroy the church? Is it to drag out the affair—because if in fact there are some core things that you simply can't touch, like who's going to be the priest, who's going to be the bishop, management, what kind of plan could you even propose?

Professor Laycock: Well, certainly those kinds of questions about religious leadership you can't touch. And the bankruptcy court cannot appoint a new bishop, although I suppose it can create a lot of political pressure on Rome to appoint a new bishop.

Judge Markell: Somehow I think my writ when received in the Holy See doesn't mean much, but that's all right.

Professor Laycock: Right. Well, it—

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[34] Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69 (1991).

Professor Lipson: You'd have to ask the international insolvency folks about that.

Judge Markell: That's right.

Mr. Phelan: Like a factual finding that the bishop is a fiscal moron.

Professor Laycock: Yeah. You also can't name the Holy See as a defendant, right? He's got sovereign immunity.

Judge Markell: Foreign sovereign immunity?

Professor Laycock: Yeah, foreign sovereign immunity.

But there's certainly no established law that says there are assets you can't touch. Maybe there ought to be. I think if we were back at the beginning and anticipating the possibility that First-Amendment-protected organizations might have unmanageable liabilities, a very sensible solution to have put in place would have been to say you maintain a reasonable amount of liability insurance and you get some exemptions. And the core assets that are necessary to operate the worship service or maybe the schools—define some core mission—they're just exempt. We don't have that body of law in place.

And to the extent the Supreme Court has talked about these kinds of issues in the church context, in the speech context, and in the defamation cases, it took a different approach. *Claiborne Hardware*[35] is a big case, with a destructive judgment against the NAACP in Mississippi back in the late '70s.

And what the Court has done is to put in constitutional defenses at the liability stage to limit the scope of liability, to create objective rules so that judges can police juries, and so forth. That didn't happen in these cases.

The dioceses, for the most part, went with an all-or-nothing First Amendment defense. They said you just can't tell us how to supervise our priests, and they won on that in a number of jurisdictions.

It became less and less tenable as more and more facts came out and the scope of the mismanagement became known. And now they're steadily losing on it. And they never offered the kind of arguments that would have held the liability to manageable bounds.

Now there's a bit of dictum in the *NAACP* case that says, "So you apply these rules. You manage liability. You're only imposing liability for things not protected by the First Amendment, not imposing liability for things that were protected. And then if it's more than they can pay, it's just too bad. It's more than they can pay."

Now it's not unimaginable that we might create under RFRA or under the First Amendment a body of exemption law for the core religious property of a religious

[35] NAACP v. Claiborne Hardware Co., 458 U.S. 886 (1982).

institution, but none of the political or conceptual work to think about how to do that has begun.

Judge Markell: Well, don't we have it? To go back to something Jonathan said, isn't that the concept of 'stable patrimony' from Canon Law?

Professor Lipson: Right. The church has told you that they think it is $3 million. And anything above $3 million, you go to the international lawyers and go to the Holy See to get your answer.

Judge Markell: Let me just ask Nancy: What kind of end game could you have?

Let's say the court says, "All right. I'm not going to impose exclusivity. They've got their plan. If you don't like it, tough. Bring on your own plan."

What would you do?

Ms. Peterman: You had asked earlier what would be the best result. There won't be any best result from the claimants' perspective.

From the claimants' perspective going into the bankruptcy case, if you cannot reach a deal, then very quickly you will seek relief from the automatic stay, because ultimately the claimants do not want to be in the bankruptcy case if it is not going to bring a resolution to the tort claims.

If you end up with a plan from the diocese that the claimants reject—and a competing plan from the claimants that may not work for the other creditors and parties in interest—it may be best to dismiss the case and avoid the litigation and appeal cost.

Judge Markell: Yeah. Then we get back to David's original question. Why haven't these people raised a good faith issue, because that would mean if in fact you can see that far down the road, that once you're in bankruptcy and find that it is someplace you don't want to be, why don't you try and short-circuit it at the first possible opportunity?

Mr. Phelan: Bruce, why wouldn't you just file a liquidating plan? If you're the tort claimants, you would file a liquidating plan to get your hands on the assets. You would either cut a deal with the parishes on whatever ambiguity exists with respect to the ownership. And that either gets litigated or the deal gets cut. And you sell off what you got.

A lot of it, I think, to some degree depends on where you are. Tucson, I have been told, was a mission diocese or is a mission diocese.

Professor Laycock: Yes.

Mr. Phelan: It really doesn't have a lot in the way of property, as opposed to a Boston or a Providence or some of these places that have lots and lots of diocesan property. You're going to have to take all that into consideration. But in a place like Boston or Providence or Cleveland or Chicago, I would suspect that you can get a lot of bucks with a liquidating plan.

Professor Laycock: I think in those places they don't wind up in bankruptcy because they can raise enough money to keep paying.

Mr. Phelan: Yeah.

Ms. Peterman: Or, a liquidating plan is proposed. This plan would liquidate the assets and distribute the cash and eliminate the future and present tort claimants' trust concepts.

Mr. Phelan: Yeah.

Professor Skeel: Who's doing the liquidating plan?

Mr. Phelan: The tort plaintiffs.

Professor Skeel: Because if the diocese did it, then you'd have some interesting potential successor liability issues. In theory the diocese could propose a liquidating plan, sell off the property, and start back up the next year.

Mr. Phelan: Yeah. What did you mean by 'successor liability' problems? You're saying if I sell the chancery building to Garbanzo Real Estate, that somehow they're liable for priests—

Judge Markell: And then Garbanzo Real Estate starts using it as a chancery building or—

Professor Laycock: There will be a new bishop appointed. There will be a diocese.

Mr. Phelan: Yeah.

Professor Laycock: And the diocese looks like a successor entity.

Mr. Phelan: But you get a discharge.

Ms. Peterman: Not if you liquidate.

Mr. Phelan: Oh, yeah, you do in section 1141[36] if you stay in business.

Judge Markell: Liquidating, right. You would.

Mr. Phelan: Yeah, if you continue your operation, which is what you're doing. I'm just talking about liquidating assets. The diocese doesn't liquidate. The diocese is going to continue to function as a diocese. It's like Doug said, the only thing it does is instead of owning the chancery building, it's got to go rent something somewhere. So I don't think you have a section 1141 problem. I think you're just going to get the discharge.

Judge Markell: We've come to that time. We started with good faith filing. We almost wound up at liquidating plans, which may be a kind of the soup to nuts or A to Z coverage.

[36] *See* 11 U.S.C. § 1141 (2000).