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# AVOIDING MORAL BANKRUPTCY

DAVID A. SKEEL, JR.\*

**Abstract:** Faced with hundreds of clergy sexual misconduct cases last year, the Archdiocese of Boston hinted that it was considering filing for bankruptcy. Although it is hard to imagine an archdiocese or church filing for bankruptcy, bankruptcy has become an important forum for many social issues that cannot be easily resolved elsewhere. This Article explores the implications of a religious organization bankruptcy filing by focusing on four problems with the bankruptcy alternative: the possibility of dismissal for being filed in bad faith; the question of what church assets are subject to the process; the fact that the church might be subject to intrusive scrutiny; and the moral implications. Although these concerns suggest that a religious organization should file for bankruptcy only as a last resort, this Article concludes that, in some circumstances, a bankruptcy filing may be appropriate.

Is bankruptcy always the answer? This may seem like an odd question with which to begin a discussion on clergy sexual misconduct and religious liberty. Indeed, as the number of cases involving priests in the Archdiocese of Boston mushroomed last year, the rumors that the Archdiocese was considering filing for bankruptcy took me—and I suspect most bankruptcy scholars—completely by surprise. It had never dawned on me that a religious organization would ever file for bankruptcy.

But perhaps it should have. In the past two decades, bankruptcy has become the forum of choice for resolving social issues that can't easily be handled elsewhere, particularly when these issues give rise to widespread litigation. Think of asbestos liability. In 1982, when Johns Manville was facing an average of three new asbestos lawsuits every hour (and over 16,500 overall), it filed for bankruptcy in the hope of getting its litigation crisis under control.<sup>1</sup> Since then, dozens of asbes-

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\* Professor of Law, University of Pennsylvania Law School. I am grateful to Mark Chopko, Bruce Markell, David Novak, Pat Schiltz, and participants at The Impact of Clergy Sexual Misconduct Litigation on Religious Liberty Symposium on April 4, 2003 at Boston College Law School for helpful comments on earlier drafts; and to Michael Sherman for research assistance. Special thanks to Jo Ann Brighton for extensive discussions (and debates) about these issues.

<sup>1</sup> For discussion, see, for example, DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 217 (2001) (quoting KEVIN J. DELANEY, *STRATEGIC*

tos manufacturers, as well as numerous companies whose asbestos involvement was less direct, have filed for bankruptcy. In theory, the wave of asbestos liability could have been dealt with in other ways. Yet, none of the most likely suspects—consolidating many or all of the cases against any given company into a single class-action lawsuit, for instance, or appointing a special judicial panel to hear all of the cases—has proven adequate to the task.<sup>2</sup> Although companies obviously would rather avoid bankruptcy if they can, bankruptcy courts have developed mechanisms for compensating the victims without destroying the enterprise from which the compensation must come.<sup>3</sup> In the asbestos cases, courts have set up trusts that are funded with much of the value of the company, and the same strategy has been used in other cases that were prompted by an avalanche of litigation. For example, trusts were set up to compensate victims of the Dalkon Shield intrauterine contraceptive device and for the thousands of cases involving Dow Corning's silicon breast implants.<sup>4</sup>

Another industry using bankruptcy to resolve social issues is the steel industry. A central issue in the steel industry today is how to balance the steel companies' promises in the past to make generous retirement payments to their employees with the need to minimize the companies' costs in the fiercely competitive global steel markets of today. Once again, this tension is being resolved in the bankruptcy courts, where much of the industry is currently doing business.<sup>5</sup>

Although asbestos manufacturers and steel companies are both large, for-profit businesses, bankruptcy is not limited to the for-profit world. When Orange County, California faced fiscal ruin in the 1990s after Robert Citron, the county's treasurer, lost millions of dollars of the county's money gambling on financial derivatives, it invoked a section of the bankruptcy laws that is designed for municipalities.<sup>6</sup> The bankruptcy laws also explicitly contemplate that ordinary nonprofit

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BANKRUPTCY: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE 60-61 (1992)).

<sup>2</sup> Congress is currently considering legislation that would put statutory limits on asbestos claims, but it remains unclear whether the legislation will be enacted. See *Fairness in Asbestos Injury Resolution Act*, S. 1125, 108th Cong. (2003).

<sup>3</sup> SKEEL, *supra* note 1, at 217-21.

<sup>4</sup> *Id.* at 217-18.

<sup>5</sup> See, e.g., Howard Brod Brownstein, *Bethlehem Steel: Death in the Family*, PHILA. INQUIRER, May 4, 2003, [http://www.nhcteam.com/death\\_in\\_family.html](http://www.nhcteam.com/death_in_family.html) ("Some two dozen American steelmakers have now gone bankrupt since 1998.").

<sup>6</sup> Orange County filed for bankruptcy under Chapter 9. For a description of the Orange County crisis, see Peter H. Huang et al., *Derivatives on TV: A Tale of Two Derivatives Debacles in Prime-Time*, 4 GREEN BAG 2D 257, 259-60 (2001).

companies may file for bankruptcy, and many of them have done just this over the years.

Now, there is an obvious difference between churches and the denizens of the bankruptcy courts that I have just mentioned. The role of the church is moral, not economic. Religious organizations cannot avoid economic issues—more money, after all, usually means more ministry—but economic issues are decidedly secondary.<sup>7</sup> The mission statement of the church I belong to, for instance, describes the church's priorities as providing sound biblical teaching and loving pastoral care. Reaching out to the needy is another central concern; this is a characteristic that churches share with many other nonprofits, and to some extent with cities. None of these entities, however, is as pervasively and irreducibly moral as churches.

I suspect this is why the response to the Archdiocese of Boston's suggestion it might be forced to file for bankruptcy was so unremittingly hostile. Shortly after Cardinal Bernard Law resigned, Alan Wolfe summed up the general consensus.<sup>8</sup> The next leader, Wolfe wrote, will, "if he has any sense, back down from the bankrupt notion of declaring bankruptcy."<sup>9</sup>

There are a lot of reasons why the Archdiocese of Boston, or other churches that face analogous crises in the future, should hesitate to invoke the bankruptcy laws. I will spend much of this Article exploring four obvious problems with the bankruptcy alternative: the possibility that the case would get kicked out as having been filed in bad faith;<sup>10</sup> the question of what church assets would get pulled into the bankruptcy process;<sup>11</sup> the fact that the church might be subject to intrusive and unwelcome scrutiny in bankruptcy;<sup>12</sup> and the moral implications of a bankruptcy filing.<sup>13</sup>

Despite these obstacles, I will argue in the end that bankruptcy is entirely defensible for a religious organization in some circumstances;

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<sup>7</sup> For fascinating accounts of the role of money in evangelical ministry, see *GOD AND MAMMON: PROTESTANTS, MONEY, AND THE MARKET, 1790–1860* (Mark A. Noll ed., 2002) and *MORE MONEY, MORE MINISTRY* (Larry Eskridge & Mark A. Noll eds., 2000).

<sup>8</sup> Alan Wolfe is the director of the Boisi Center for Religion and American Public Life at Boston College.

<sup>9</sup> Alan Wolfe, *The Men Who Disappeared*, *BOSTON GLOBE*, Dec. 22, 2002, at D1, available at [http://www.boston.com/globe/spotlight/abuse/stories4/122202\\_wolfe.htm](http://www.boston.com/globe/spotlight/abuse/stories4/122202_wolfe.htm).

<sup>10</sup> See *infra* Part I.

<sup>11</sup> See *infra* Part II.

<sup>12</sup> See *infra* Part III.

<sup>13</sup> See *infra* Part IV.

it may even prove to be the most sensible solution.<sup>14</sup> Bankruptcy would be morally bankrupt, as Wolfe suggested, if a church used it to evade its obligations to the victims of clergy sexual misconduct.<sup>15</sup> But this isn't the only way that the bankruptcy process can be used.

### I. GOOD OR BAD FAITH?

The first question is whether churches or other religious organizations are even permitted to file for bankruptcy. If American bankruptcy law excluded religious organizations, the debate as to whether bankruptcy is an appropriate solution would never get off the ground. But bankruptcy law itself is easily capacious enough to encompass churches and other religious organizations. As we shall see, this does not necessarily mean that any church could file for bankruptcy if it wished to do so. The point is simply that religious organizations meet the literal requirements for filing a bankruptcy petition, the "letter" of the bankruptcy law.

Here is how it works. With a few exceptions, any "person" is entitled to invoke Chapter 11, the principal reorganization provisions of the Bankruptcy Code.<sup>16</sup> "Person," of course, includes far more than men, women and children. In the inimitable way of the law, nearly any individual, partnership, or corporation qualifies as a "person."<sup>17</sup> The question, then, is whether an archdiocese or church fits within any of these categories. The answer will almost always be "yes." Most churches are organized as nonprofit corporations of one form or another, and the bankruptcy laws make clear that "corporation" should be construed quite broadly. The term includes nonprofits as well as for-profit corporations. In fact, even entities that are not technically corporations, such as an "unincorporated company or association," are treated as corporations for the purposes of bankruptcy law.<sup>18</sup>

The Archdiocese of Boston is a good illustration. The Archdiocese is structured as a "corporation sole"—an ecclesiastical corporation that is controlled by a single individual, in this case the cardinal

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<sup>14</sup> See *infra* Part V.

<sup>15</sup> See Wolfe, *supra* note 9, at D1.

<sup>16</sup> 11 U.S.C. § 109 (2000). The "persons" who cannot file for Chapter 11 include stockbrokers, who can file for Chapter 7 (which provides for liquidation rather than reorganization) but not Chapter 11, and banks and insurance companies, which have their own, separate regulatory structures and are therefore excluded from both Chapter 7 and Chapter 11. *Id.*

<sup>17</sup> *Id.* § 101(41) (defining "person").

<sup>18</sup> *Id.* § 101(9) (defining "corporation").

overseeing the Archdiocese.<sup>19</sup> There is no question that the Archdiocese meets the technical, statutory requirements for filing a bankruptcy petition.

Notice what the bankruptcy law does not require. It does not require debtors to demonstrate that they are insolvent when they file for bankruptcy.<sup>20</sup> Under the old Bankruptcy Act, which was replaced by the current Bankruptcy Code in 1978, an entity that wished to file for bankruptcy generally had to demonstrate that its liabilities exceeded its assets.<sup>21</sup> No more. The drafters of the current Code deliberately omitted the insolvency requirement. In theory, at least, a financially healthy debtor can file for bankruptcy if it so chooses.

The reality, however, is a bit more complicated. Although the statutory prerequisites for filing for bankruptcy are quite limited, courts have long hesitated to make bankruptcy available to debtors that do not seem to belong there. If a debtor files for bankruptcy for reasons other than a genuine need to restructure its debts, courts sometimes conclude that the case has not been filed in good faith and kick it out.<sup>22</sup> It is this implied duty of good faith that raises the first serious question concerning the Archdiocese of Boston's hint that it might file for bankruptcy.

The question posed by a series of high profile cases—including Continental Airlines' decision to file for bankruptcy largely to terminate its collective bargaining agreement in 1984 and the use of bankruptcy by Johns Manville and other asbestos manufacturers to consolidate their defense to litigation by tort victims—was whether companies were violating the good faith obligation by filing for bank-

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<sup>19</sup> Nearly every state has a statute authorizing the formation of a corporation sole and vesting decision-making authority in the head of the religious organization in question. For a useful description and analysis of one state's corporation sole provisions, see UTAH DIV. OF CORPS. AND COMMERCIAL CODE, CORPORATION SOLE: HOW TO INCORPORATE (2002), at <http://www.commerce.utah.gov>.

<sup>20</sup> See, e.g., Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 921 n.7 ("Conspicuous by its absence from the Bankruptcy Code is any requirement that the debtor be insolvent in either an equity or balance sheet sense.")

<sup>21</sup> *Id.*

<sup>22</sup> The principal statutory basis for dismissing a bankruptcy petition on good faith grounds is 11 U.S.C. § 1112(b), which authorizes the bankruptcy court to dismiss a case "for cause." Section 1112(b) gives a laundry list of bases for dismissal, including factors such as the absence of a reasonable likelihood of reorganization. Lack of good faith is not listed, but some courts have deemed it an implicit requirement; see also 11 U.S.C. § 305 (authorizing bankruptcy court to dismiss a case if "the interests of creditors and the debtor would be better served by such dismissal or suspension").

ruptcy solely for strategic advantage.<sup>23</sup> In each of these cases, the court permitted the case to go forward. More recently, however, the United States Court of Appeals for the Third Circuit in *In re SGL Carbon Corp.* did not.<sup>24</sup> As we shall see, *SGL Carbon* sheds significant light on the implications of an archdiocese bankruptcy filing.

*SGL Carbon* involved a manufacturer of graphite electrodes that had been accused of price fixing by numerous steel producers who purchased the electrodes for use in the production of steel.<sup>25</sup> A group of the lawsuits were consolidated into a single class action, but many of the members of the intended class action opted out in order to file their own, separate antitrust lawsuits. In the face of this wave of litigation, the impact of which was initially estimated by the company itself at \$240 million, *SGL Carbon* filed for bankruptcy on December 16, 1998. The next day, *SGL Carbon* issued a press release announcing that it had filed for bankruptcy "to protect itself against excessive demands made by plaintiffs in civil antitrust litigation and in order to achieve an expeditious resolution of the claims against it." The press release emphasized that "*SGL Carbon Corporation* is financially healthy." "If we did not face [antitrust] claims for such excessive amounts," the missive explained, "we would not have had to file for Chapter 11."

The similarities between *SGL Carbon's* and the Archdiocese of Boston's predicaments are striking. In each case, the crisis stemmed from the prospect of enormous liability from lawsuits filed against an otherwise financially healthy entity. Were it not for this litigation—litigation based in each instance on alleged misbehavior involving the would-be debtor itself—the prospect of bankruptcy would never have arisen.<sup>26</sup> The question in each instance is whether the "distractions" of

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<sup>23</sup> See generally *In re Johns-Manville Corp.*, 36 B.R. 727 (Bankr. S.D.N.Y. 1984); *In re Continental Airlines Corp.*, 38 B.R. 67 (Bankr. S.D. Tex. 1984). For a thorough discussion of the cases, see Ponoroff & Knippenberg, *supra* note 20, at 933-38.

<sup>24</sup> 200 F.3d 154, 165-66 (3d Cir. 1999).

<sup>25</sup> The facts discussed below are described at the outset of the *SGL Carbon* opinion. *Id.* at 156-58.

<sup>26</sup> Indeed, the clergy sexual misconduct liability could probably not be discharged by any of the priests themselves if they filed a Chapter 7 bankruptcy petition on their own behalf. Under 11 U.S.C. § 523(a)(6), willful and malicious injuries cannot be discharged in Chapter 7, although they can be discharged if the individual involved proposes a three- to five-year rehabilitation plan pursuant to Chapter 13 instead. See 11 U.S.C. §§ 523, 1328. Because the nondischargability provision applies only to individuals, not to entities, it would not preclude an archdiocese or church from obtaining a bankruptcy discharge. For further discussion of the implications of Chapter 13 for individual priests, see *infra* note 43.

litigation that "posed a serious threat to [the company's] continued successful operations," as the District Court put it, and which "could cause . . . financial and operational ruin," are a sufficient basis for invoking the bankruptcy laws.<sup>27</sup>

In *SGL Carbon*, the Third Circuit said no. Only if the Chapter 11 petition "serves a valid reorganizational purpose," the court concluded, does it qualify as having been filed in good faith.<sup>28</sup> Filing for bankruptcy "merely to obtain tactical litigation advantages" does not meet this standard. The court was particularly troubled by the fact that SGL Carbon had no financial concerns other than the antitrust exposure, that it had filed for bankruptcy solely to address the litigation, and that the company emphasized that bankruptcy would not interfere with its normal business operations in any way.<sup>29</sup>

*SGL Carbon* highlights a significant risk to a diocese or archdiocese that decides to file for bankruptcy in order to address clergy sexual misconduct litigation. The bankruptcy petition would almost certainly be challenged by one or more of the tort plaintiffs as having been filed in bad faith, and the plaintiffs could make the same kinds of arguments that won the day in *SGL Carbon*. In some respects, the arguments for barring the doors of bankruptcy are even stronger with respect to the Archdiocese of Boston. The Archdiocese appears to have relatively little debt other than its potential tort liability, for instance, which suggests that a bankruptcy case could be seen as having no "reorganizational purpose" beyond the Archdiocese's desire to address the numerous lawsuits filed by the victims of alleged misconduct.

The risk of dismissal on bad faith grounds is just that—a risk, not a certainty. As noted earlier, courts have permitted companies to file for bankruptcy, in a series of prominent cases, despite concerns that the filing was strategic in nature. The mass tort cases—*In re Johns-Manville Corp.* and its peers in the asbestos industry, and the Dalkon Shield and silicon breast implant cases—all can be seen as fitting this pattern, as can *In re Continental Airlines Corp.*, although the threat to the economic viability of these enterprises was more obvious than with either SGL Carbon or the Archdiocese.<sup>30</sup>

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<sup>27</sup> *SGL Carbon*, 200 F.3d at 162.

<sup>28</sup> *Id.* at 165.

<sup>29</sup> *Id.* at 162–63.

<sup>30</sup> See, e.g., *Johns-Manville*, 36 B.R. at 729; *Continental Airlines*, 38 B.R. at 71. The single most dramatic example of bankruptcy being used to achieve a litigation objective came in the Texaco bankruptcy, in which the good faith issue was debated but never formally de-



The point, then, is this: although nothing in the bankruptcy laws precludes an archdiocese or church from filing for bankruptcy, a Chapter 11 petition by the Archdiocese would probably be challenged on good faith grounds. Given that the Archdiocese is financially healthy apart from the estimated five hundred clergy sexual misconduct cases filed against it, a bankruptcy court could conclude that the Archdiocese does not have an a genuine "reorganizational purpose" and should therefore be kicked out of Chapter 11.

## II. WHAT CHURCH ASSETS MIGHT GET PULLED INTO THE CASE?

Suppose the Archdiocese or other religious organization weathered this initial storm and persuaded the court that it belonged in bankruptcy. What other concerns might then lie in store?

The second major issue—an issue that has figured prominently in media accounts of the Archdiocese of Boston's crisis—is what bankruptcy would mean for the Archdiocese's assets. Media coverage has raised the specter of tort victims foreclosing on Archdiocese schools and churches in order to satisfy judgments against the Archdiocese.<sup>31</sup> There also are questions as to whether the Archdiocese's creditors might seek to "pierce the veil" to hold the Vatican responsible for the Archdiocese's obligations, and as to what effect an Archdiocese bankruptcy would have on the liability of individual priests.

Start with the churches and schools. Bankruptcy actually makes seizure of a church or school less—rather than more—likely. As soon as a bankruptcy petition is filed, an "automatic stay" goes into effect.<sup>32</sup> The stay prohibits creditors from foreclosing on property or taking any other step to collect what they are owed.<sup>33</sup> To the extent the churches and schools were Archdiocese property—an issue about which there has been some dispute—their value would need to be taken into account in the Archdiocese's negotiations with its credi-

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cided. Texaco was able to reorganize in Chapter 11 even though it was fully solvent and filed for bankruptcy solely to renegotiate the terms of a \$10.53 billion judgment it owed to Pennzoil after being found liable for interfering with Pennzoil's attempted acquisition of Getty Oil. See DELANEY, *supra* note 1, at 144–54; see also Ponoroff & Knippenberg, *supra* note 20, at 938–39.

<sup>31</sup> See, e.g., Pam Belluck, *Boston Church Panel Will Allow Archdiocese to Weigh Bankruptcy*, N.Y. TIMES, Dec. 5, 2002, at A1, A38 (suggesting that bankruptcy would "giv[e] a judge control over which church land or buildings might be sold to pay plaintiffs").

<sup>32</sup> 11 U.S.C. § 362(a) (2000).

<sup>33</sup> See *id.* The automatic stay is commonly described as giving the debtor "relief from its creditors."

tors, but the automatic stay would prevent, say, an angry creditor from seeking to have them seized.<sup>34</sup>

When an ordinary corporation files for bankruptcy, the stay alone does not provide complete protection against seizure and sale of the company's assets. If creditors believe that liquidating the company's property makes more sense than trying to negotiate a restructuring, they can ask the bankruptcy court to convert the case from Chapter 11—the reorganization provisions of the Bankruptcy Code—to Chapter 7, which provides for liquidation.<sup>35</sup> The Archdiocese, by contrast, would not face this threat. Because the Archdiocese is a nonprofit corporation, it would be subject to more favorable treatment under the bankruptcy laws than an ordinary, for-profit business. Nonprofit corporations cannot be thrown into bankruptcy involuntarily,<sup>36</sup> and the bankruptcy laws forbid a court from converting a case filed by a nonprofit from Chapter 11 to Chapter 7 unless the nonprofit itself agrees to the conversion.<sup>37</sup> Together, then, bankruptcy's standstill provision and the protection against being pushed into Chapter 7 make it unlikely that a bankruptcy filing would lead to the forced sale of one of Boston's cathedrals or a parochial school building.<sup>38</sup>

What about the other parties who have been named in clergy sexual misconduct litigation—the priests who allegedly abused parishioners, and officials higher up in the hierarchy of the Roman Catholic Church (the "Church")? Would a bankruptcy filing also shelter them and their assets? With respect to the priests, bankruptcy would have no effect on any criminal prosecutions commenced against them, as the automatic stay does not interfere with criminal actions.<sup>39</sup> With

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<sup>34</sup> Although the Archdiocese seems to hold title to the property as a corporation sole, Church lawyers have hinted that they might contend that the property is actually held in trust for the parishioners within the Archdiocese, and that the head of the Archdiocese is simply a trustee for the interests of the parishioners. See, e.g., Justin Pope, *Questions and Answers About the Boston Archdiocese Chapter 11 Bankruptcy*, Dec. 11, 2002 (unpublished manuscript, on file with author).

<sup>35</sup> 11 U.S.C. § 1112(b) (conversion to Chapter 7 when this is in the best interest of creditors).

<sup>36</sup> *Id.* § 303(a) (excluding nonprofits from involuntary bankruptcy).

<sup>37</sup> *Id.* § 1112(c).

<sup>38</sup> If any of the Archdiocese's churches or schools were subject to a significant mortgage, the mortgagee could ask the court to lift the stay in order to permit a foreclosure. *Id.* § 362(d) (providing several bases for lifting the stay, including "cause" and the absence of equity in property that is not necessary to an effective reorganization). The Archdiocese's property, however, does not seem to be subject to any substantial mortgages, which makes this step unlikely.

<sup>39</sup> *Id.* § 362(b)(1) (criminal actions not stayed).

civil litigation, however, things are not quite so simple. Technically, the bankruptcy stay applies only to the debtor itself and not to third parties such as officers or employees of the debtor. Courts, however, have sometimes extended the stay beyond the debtor itself when the restructuring effort would be derailed in the absence of a more sweeping standstill. In the most prominent case, in 1986, the United States Court of Appeals for the Fourth Circuit in *A.H. Robins Co. v. Piccinin* relied heavily on the fact that a single insurance policy covered both the company and several of its executives, who had also been sued.<sup>40</sup> If efforts to sue the executives were not enjoined, according to the court, the litigation could "reduce and diminish the insurance fund or pool represented in [the insurance policy] and thereby affect the property of the debtor to the detriment of the debtor's creditors as a whole."<sup>41</sup> The insurance rationale carries little water in the clergy sexual misconduct context, both because the Archdiocese's coverage was relatively limited and because it would not protect priests who engaged in intentional misconduct.<sup>42</sup> A bankruptcy court might still bring a halt to litigation against the priests, on the view that the litigation is so central to resolution of the Archdiocese's financial difficulties that it should be handled in connection with the bankruptcy case, rather than permitted to go forward. This is the most sensible conclusion, in my view, but it is far from certain. The court might well conclude that the arguments for an extended stay are insufficient, and that the individual priests should file for bankruptcy themselves if it is essential that the litigation against them be put on hold.<sup>43</sup>

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<sup>40</sup> 788 F.2d 994, 1001, 1007-08 (4th Cir. 1986).

<sup>41</sup> *Id.* at 1008.

<sup>42</sup> Although the Archdiocese had roughly \$100 million in liability insurance, the amount of coverage in place in any given year was quite small. See, e.g., Justin Pope, *Bankruptcy Wouldn't Solve All Archdiocese Problems*, ASSOCIATED PRESS, Aug. 9, 2002.

<sup>43</sup> The possibility that the priests themselves might file for bankruptcy raises several additional issues, which are worth briefly noting here. The principal choices for an individual who files for bankruptcy are Chapter 7, which provides for an immediate discharge, and Chapter 13, which contemplates a three- to five-year repayment plan. As noted earlier, if a priest filed for Chapter 7, he would not be permitted to discharge any sexual misconduct liability if the liability constituted "willful and malicious injury by the debtor." 11 U.S.C. § 523(a)(6). Under the so-called "superdischarge" of Chapter 13, on the other hand, even liability for willful and malicious injury can be discharged. *Id.* § 1328(a). This would make Chapter 13 the obvious choice. But to invoke Chapter 13, the priest would need to show that he had "regular income" (which could be difficult unless the church is paying the priest a salary or pension), and Chapter 13 would not be available if a plaintiff had already obtained a large judgment. Chapter 13 is only available to debtors who have

Here, then, is another risk to the Archdiocese in the event it files for bankruptcy. If the court refuses to stay the litigation against individual priests, the Archdiocese would incur all of the downsides of bankruptcy—including the stigma it could entail—without achieving one of its important potential benefits—an orderly resolution of the misconduct litigation.

Another risk of filing for bankruptcy is that creditors would insist that responsibility for the Archdiocese's obligations extends beyond the Archdiocese itself. Creditors might argue that the finances of the Vatican (or, perhaps, other archdioceses) and the Archdiocese are so closely intertwined that the Vatican should be responsible for all of the Archdiocese's obligations. There is, of course, a long tradition in American corporate law of "piercing the corporate veil" when the parties have ignored corporate boundaries, and holding higher-ups responsible if they clearly are the ones pulling the strings.<sup>44</sup> Based on this reasoning, the victims of alleged clergy sexual misconduct could try to pull the Vatican into the case.

It is of course extremely unlikely that the Vatican could be held responsible for clergy sexual misconduct, no matter how closely intertwined its assets are with those of the Archdiocese. The Vatican's sovereign immunity would insulate it from any direct liability. The Vatican's immunity would not make the veil-piercing argument irrelevant, however. Even if the Vatican could not be compelled to contribute financially to any settlement or judgment, creditors could raise the issue indirectly. They could point to the absence of a Vatican contribution as evidence that any proposed reorganization plan was not filed in good faith, and thus should not be confirmed.<sup>45</sup>

How serious is the risk that a court would be persuaded to insist upon a substantial Vatican contribution? Even apart from any First Amendment concerns, the likelihood that a court would indirectly pierce the corporate veil seems relatively small. There is much less financial interdependence between the Vatican and any given diocese or archdiocese than many observers assume. For instance, the Vatican

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less than \$807,750 in secured debt and less than \$269,250 in unsecured debt. *See id.* § 109(e) (requirements for filing under Chapter 13).

<sup>44</sup> Recent veil-piercing cases are extensively surveyed in Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991). For a classic defense of holding the separate parts of a larger enterprise liable for one another's obligations, see generally Adolph A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343 (1947).

<sup>45</sup> *See* 11 U.S.C. § 1129(a)(3) ("good faith" requirement for confirmation of reorganization plan).

rarely contributes money to an archdiocese; and contributions running from an archdiocese to the Vatican are slightly more common, but still extremely limited in scope.<sup>46</sup> If secular corporations maintained this degree of separation, the arguments for holding the parent entity responsible would be viewed as weak. Nevertheless, the risk that the Vatican would be pulled into the case—at least indirectly—cannot be dismissed. This is one more reason that an archdiocese should think twice before filing for bankruptcy.

### III. THE PERILS OF INTRUSIVE BANKRUPTCY SCRUTINY

There's more. A hallmark of Chapter 11 is that it provides for pervasive court oversight and extensive scrutiny of the entity throughout the bankruptcy process. An entity that files for bankruptcy is required to submit a list of all of its creditors, as well as "a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs."<sup>47</sup> And this is only the beginning, the price of admission to Chapter 11. Chapter 11 debtors and those who run them are required to provide ongoing information about the entity's finances. Creditors and other parties in interest are entitled to examine the debtor, its assets and its officers.<sup>48</sup> The rationale, of course, is that creditors need a clear picture of the debtor's financial status to decide what the next step should be—whether the debtor should be restructured and, if so, on what terms.

A church or diocese that filed for bankruptcy would thus be required, as a bankruptcy lawyer recently put it, to "open up all of its closets and drawers."<sup>49</sup> For the Archdiocese of Boston, this would mean submitting the records of its schools—teachers' salaries, the costs of administration, the extent of any subsidies from Church coffers—to public scrutiny. The income and expenses of each of the Archdiocese's churches would be subject to the same kind of scrutiny. This policy of full disclosure does not fit easily with the desire of most religious institutions to keep their inner workings private.

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<sup>46</sup> See *Religion & Ethics Newsweekly: Catholic Church Finances* (Thirteen/WNET New York television broadcast, July 12, 2002), <http://www.pbs.org/wnet/religionandethics/week545/feature.html> (transcript).

<sup>47</sup> 11 U.S.C. § 521(1).

<sup>48</sup> See, e.g., FED. R. BANKR. P. 2004 (authorizing examination, including right to compel attendance and production of documentary evidence).

<sup>49</sup> Telephone interview with Jo Ann Brighton, Partner, Nixon Peabody LLP (Apr. 1, 2003).

In addition to—and even more invasive than—these disclosure obligations, Chapter 11 also calls for extensive oversight of nearly every significant decision made by the debtor. Suppose, for instance, that an archdiocese wished to start a new school on Church property in an underserved part of the city. In bankruptcy, the cardinal or other archdiocese decisionmakers could not make this determination on their own because bankruptcy requires court approval of any decision to “use, sell, or lease” property that is not in the ordinary course of business.<sup>50</sup> The same strictures would apply to any other major archdiocese decision. It is not hard to imagine conflicts between creditors, whose interests may be principally financial, and the spiritual and eleemosynary goals of the archdiocese. What should the bankruptcy court do if the archdiocese believes that it must expand its programs for the poor, but creditors resist? Or what if disagreements arise about the amount of money a church contributes to foreign missions programs?

The last possible intrusion is the most dramatic of all, and it highlights the awkward fit between religious organizations and America's bankruptcy laws. If the creditors lose confidence in the men and women who are running a business in Chapter 11, they have the power to ask the bankruptcy court to replace the managers with a trustee. “At any time after the commencement of the case,” according to the relevant provision, the bankruptcy court “shall order the appointment of a trustee” if there is “cause, including fraud, dishonesty, incompetence, or gross mismanagement,” or “if such appointment is in the interests of creditors” and other interested parties.<sup>51</sup> To be sure, there is an obvious *Twilight Zone* quality to the possibility that a bankruptcy court might oust an archbishop or other Church leader and put the archdiocese's schools (and in theory, even its churches) in the hands of a court-appointed trustee. Even apart from any First Amendment concerns, it seems quite unlikely that a bankruptcy court would ever agree to inject itself into Church affairs this directly. Indeed, the creditors' option of calling for a trustee seems to demonstrate nothing more than that the drafters of Chapter 11 never contemplated that a religious organization might file for bankruptcy. In the similarly ticklish context of municipal bankruptcy, the drafters were quite careful to make clear that the bankruptcy court has no power to interfere in any way with “any of the political or governmen-

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<sup>50</sup> 11 U.S.C. § 363(b).

<sup>51</sup> *Id.* § 1104 (emphasis added).

tal powers of the debtor."<sup>52</sup> If the drafters had considered the possibility that an archdiocese might invoke Chapter 11, I suspect they would have erected a similar wall between the bankruptcy process, on the one hand, and the internal workings of the Church, on the other. Still, the facts that bankruptcy courts are unlikely to exercise their ostensible authority to appoint a trustee, and that this authority is more accidental than intended in this context, do not make the possibility of a trustee irrelevant. Although one would not expect the creditors of most religious organizations even to threaten to ask for a trustee, the level of outrage with clergy sexual misconduct is so high that one can envision one or more of the victims and their lawyers taking this step.

What about the First Amendment concerns that I alluded to a moment ago? For a reader with even a passing acquaintance with religious freedom and the Free Exercise Clause of the First Amendment, each level of scrutiny I have described—the disclosure obligations, the judicial oversight of financial decisions and, most startlingly, the possibility of a trustee—raises obvious questions. Would not some or all of these intrusions be unconstitutional? The most dramatic intervention, replacing church leaders with a trustee, probably would be, but the answer is much less clear with the other standard forms of bankruptcy scrutiny. On several different occasions in recent years, the United States Supreme Court has made clear that bankruptcy is a privilege, not an entitlement.<sup>53</sup> When individuals or entities file for bankruptcy, or file pleadings in a bankruptcy case, they waive their right to insist on many of the protections that might otherwise be available to them.<sup>54</sup> This reasoning suggests that an archdiocese that filed for bankruptcy would be required to disclose as much financial information as any other debtor; and it might also be held to justify court oversight over major financial decisions made by the archdiocese during the course of the bankruptcy case.

In short, a church or archdiocese that filed for bankruptcy would, by virtue of the filing, be consenting to a significant lowering of the wall of separation between church and state.

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<sup>52</sup> *Id.* § 904(1). This section also prevents the court from interfering with "any of the property or revenues of the debtor," or "the debtor's use or enjoyment of any income-producing property." *Id.* § 904(2)-(3).

<sup>53</sup> See, e.g., *Grogan v. Garner*, 654 U.S. 278, 286 (1991) (citing *United States v. Kras*, 409 U.S. 434, 445-46 (1973)).

<sup>54</sup> See, e.g., *Langenkamp v. Culp*, 498 U.S. 42, 45 (1990) (creditor who files claim waives right to a jury trial).

## IV. BANKRUPTCY AS A MORAL ISSUE

Up to this point, I have been careful to downplay as much as possible the explicitly moral questions as to whether it is, or ever would be, appropriate for a church or archdiocese to file for bankruptcy. Eliding these issues is no easy feat, of course, since the bankruptcy decision is pervasively moral in nature. Moral considerations are the fourth and most important reason why religious organizations should think long and hard before filing for Chapter 11.

Although there is a longstanding debate as to the morality of filing for bankruptcy, the debate has tended to focus on slightly different issues than those at stake in the clergy sexual misconduct context. When an individual encounters financial distress, the question we usually ask is whether it is appropriate for her to discharge—and thus fail to pay—the obligations that she has assumed. In my own, protestant Christian tradition, critics of bankruptcy have emphasized a smattering of scriptural passages that underscore the importance of repaying one's debts. The Bible notes that "[t]he wicked borrow and do not repay," for instance; and the Apostle Paul admonished the Romans to "Let no debt remain outstanding, except the continuing obligation to love one another."<sup>55</sup> The usual argument is that a promise is a promise, and that there is no excuse for failing to honor the financial commitments we make.<sup>56</sup>

Now, whatever one thinks of this debate, it has a slightly different emphasis than the questions raised by clergy sexual misconduct liability. Stripped of its subtleties, debates about bankruptcy morality usually concern contractual liabilities, debts that a person promised to pay; here, by contrast, the liability comes from a tort—from misbehavior by priests for which both the priests and the archdiocese are likely to be responsible. The fact that the liability is imposed by law, rather than contracted for by the archdiocese, does not mean an archdiocese can simply ignore it and file for bankruptcy without a second thought, of course. But we need to look at it through a slightly differ-

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<sup>55</sup> *Psalms* 37:21 ("The wicked borrow . . ."); *Romans* 13:8 ("Let no debt remain . . .").

<sup>56</sup> The most prominent Christian financial writers—including Larry Burkett and Ron Blue—have tended to take this view, suggesting that Christians should never file for bankruptcy. See, e.g., RON BLUE, *THE DEBT SQUEEZE: HOW YOUR FAMILY CAN BECOME FINANCIALLY FREE* 42–43 (1989) (concluding that borrowers have "no alternative" other than to repay, and that "[f]ailing to repay is to violate the command in *Psalms* 37:21"); LARRY BURKETT, *DEBT-FREE LIVING* 59–60 (1989) (citing *Ecclesiastes* 5:5 and concluding that borrowers have an absolute commitment to repay).



ent lens.<sup>57</sup> Unlike with contractual obligations, which raise questions about the nature of one's promises, the real issue in the clergy sexual misconduct context is accountability—the accountability of both the archdiocese and the priests themselves to those who have been harmed by the horrifying abuses that have been alleged in the litigation.

The Bible has a great deal to say about accountability—much more than it says about repaying one's debts, or about almost any other issue other than salvation. Oppression of the weak and powerless is and always has been a problem both for churches and in the secular world. The prophets, the psalmists, and Christ himself returned to this theme again and again. The just king to whom the psalmist looks, to give just one illustration, "will take pity on the weak and the needy and save the needy from death./He will rescue them from oppression and violence, for precious is their blood in his sight."<sup>58</sup>

It does not take any great insight to apply these admonitions to our context, the moral implications of a church bankruptcy filing. If a church's decision to file for bankruptcy meant turning its back on those who have been harmed, Chapter 11 obviously would fly in the face of the Bible's teaching on accountability to those who are oppressed.

There is another, related concern as well: how would a bankruptcy filing be perceived by those outside the Church? The perceived "stigma" of bankruptcy dissuades many financially troubled debtors from filing for bankruptcy.<sup>59</sup> Although the stigma of bankruptcy seems to have diminished in recent years—this surely is part of the explanation for the astonishingly high number of bankruptcy filings<sup>60</sup>—it has not disappeared altogether. The impact to a religious

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<sup>57</sup> For a secular moral argument that it is more defensible to discharge tort obligations than contractual ones due to the absence of a promise to pay, see generally Philip Shuchman, *An Attempt at a "Philosophy" of Bankruptcy*, 21 UCLA L. REV. 403 (1974).

<sup>58</sup> *Psalms* 72:13–14.

<sup>59</sup> See Amanda E. Dawsey & Lawrence M. Ausubel, *Informal Bankruptcy* (Feb. 2002), at <http://www.ausubel.com/creditcard-papers/informal-bankruptcy.pdf>; Michelle J. White, *Why it Pays to File for Bankruptcy: A Critical Look at Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change*, 65 U. CHI. L. REV. 685, 697–99 (1998) (concluding that many American families could gain financially if they were to file for bankruptcy).

<sup>60</sup> The number of bankruptcy filings exceeded one million per year for the first time in 1996, and it has hovered around 1.5 million the past several years. The numbers seem to reflect both a decrease in the stigma of filing for bankruptcy and a dramatic increase in access to credit cards and other consumer debt. See SKEEL, *supra* note 1, at 188 (table showing 1978–98 filing data); Todd Zywicki, *Why So Many Bankruptcies and What to Do About It:*

organization that was perceived to be walking away from its responsibilities would be vastly greater. A church's ability to preach to outsiders, and even to minister to its own members, would be seriously undermined if it seemed unwilling to face up to its own problems.

Notice the connection between the morality of bankruptcy from the church's perspective, on the one hand, and the bankruptcy stigma, on the other. Each pivots on the church's accountability. Using bankruptcy to limit a church's responsibility to those who have been harmed would contradict the church's own teachings; and the perceived failure to take full responsibility would tarnish the church's reputation in the world—that is, it would magnify the bankruptcy stigma.

#### V. THE CASE FOR BANKRUPTCY

"After the final no," Wallace Stevens wrote in a well-known poem, "there comes a 'yes.'"<sup>61</sup> Like the Stevens poem, this Article has catalogued an extensive list of "nos." We have seen a litany of reasons why religious organizations should think twice before filing for bankruptcy. Each of the concerns—the morality of bankruptcy, the risk that the filing will be kicked out, the implications of bankruptcy for church assets, the intrusion of bankruptcy oversight—is both legitimate and real. But under carefully limited conditions, a bankruptcy filing might make sense. There is a case for bankruptcy, a "yes," and I will conclude this Article by attempting to make it.

The key issue is the one arrived at last: accountability. Unless it somehow reflected a commitment to those who have been harmed, a church's Chapter 11 filing would not be morally defensible. I should emphasize that the victims we need to focus on first are the immediate victims of clergy sexual misconduct. One sometimes hears the argument that the Church needs to file for bankruptcy, and to scale down its liability to these victims, so that it will have sufficient financial resources to help others who are in need elsewhere.<sup>62</sup> The Church's continued capacity for ministry is crucially important, but the princi-

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*An Economic Analysis of Consumer Bankruptcy Law and Bankruptcy Reform*, at 5, <http://ssrn.com/abstract=454121> (2003) ("In 2002 bankruptcy filings for the first time exceeded 1.5 million; early reports for 2003 indicate a further rise this year.")

<sup>61</sup> Wallace Stevens, *The Well-Dressed Man with a Beard*, in *THE COLLECTED POEMS OF WALLACE STEVENS* 247 (1954).

<sup>62</sup> See Catharine Pierce Wells, *Churches, Charities, and Corrective Justice: Making Churches Pay for the Sins of Their Clergy*, 44 B.C. L. REV. 1201, 1202–03, 1214–15 (2003).

pal objective must be to minister to those who have been abused—the victims.

How, then, can bankruptcy be reconciled with this kind of accountability? The short answer is that a church that files for bankruptcy should commit from the outset to make complete restitution to every victim of clergy sexual misconduct. Although bankruptcy is ordinarily used to restructure and reduce the debtor's obligations, it also can be used to solve related problems, such as coordinating the debtor's response to a wave of litigation. The obvious analogues to the Archdiocese of Boston's situation are the asbestos and other mass tort bankruptcies to which I alluded earlier.<sup>63</sup> Although some of the debtors have significantly restructured their liability, the goal of most has been to set up a mechanism for providing payment to the victims of the torts in question. The standard strategy for handling these cases is to establish administrative procedures for determining the extent of the company's liability to each victim. Payments to the victims are then made by a trust that is set up for this purpose, and which is usually funded by a combination of stock, other securities of the debtor, and cash.<sup>64</sup>

Some commentators have argued that the best way to handle the rash of litigation against the Church would be through an administrative process within the Church itself.<sup>65</sup> If the Church itself processed the claims, they argue, and demonstrated a commitment to fully compensating the victims, it could shift out of the current litigation mode and into a more administrative one; no longer would the Church be in the awkward position of defending itself with legal arguments that seem to cast doubt on the Church's willingness to accept responsibility for the misbehavior of some of its priests. An important benefit of Chapter 11, as demonstrated by the asbestos bankruptcies, Dalkon Shield litigation, and breast implant litigation, is that it can be used to achieve precisely the same result.

To be sure, the parties would need to address a variety of compensation-related questions as they set up the fund. Obvious issues include the question of how to compensate psychological injuries such as pain and suffering and whether to permit punitive damages.

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<sup>63</sup> See *supra* notes 3–4 and accompanying text.

<sup>64</sup> The trust fund strategy employed in the *In re Johns-Manville Corp.* case has now been enshrined in the Bankruptcy Code, 11 U.S.C. § 524(g) (2000) (procedures for trust funds in asbestos cases); see SKEEL, *supra* note 1, at 217–18.

<sup>65</sup> Patrick Schiltz, for instance, noted at the Boston College Law School Symposium that he has made this argument in a variety of contexts in recent years.

These are difficult issues—although the asbestos cases have excluded punitive damages, for instance, it is less clear that exemplary damages should be excluded altogether in this context.<sup>66</sup> Whatever the appropriate structure, it will not be put in place unless a majority of the victims agree to the terms. Under Chapter 11, each class of claims is entitled to vote to approve the terms of a proposed restructuring.<sup>67</sup> Because the clergy sexual misconduct victims are by far the largest creditors of the Archdiocese of Boston—which has little other debt—their votes would determine whether a proposed payout framework went forward. The success or failure of a proposal would be largely in the victims' hands.

What about the other concerns we have considered? Each is a genuine issue, but none would rule out a bankruptcy filing altogether. If the Archdiocese made clear that it intended to fully compensate all of the victims, it seems unlikely that a bankruptcy court would throw the case out as having been filed in bad faith. A generous compensation framework would make it easier to resolve debates over the responsibility of other dioceses or the Vatican. The financial scrutiny that would attend a bankruptcy filing could not be avoided; the Archdiocese would be forced to reveal far more about its finances than ever before. But it is not clear that financial transparency, at least in this context, is such a bad thing. To confirm that the Archdiocese is truly committed to compensating the victims, we—and more importantly, the victims—need to know more about the economic condition of the Archdiocese.

It is no accident that religious organizations so rarely consider filing for bankruptcy. Most churches have few creditors, and they depend almost entirely on the regular tithes and offerings given by their congregations for support. If the congregation is too small to sustain the church, the church simply relocates or closes. The clergy sexual misconduct scandal is a dramatic exception to this pattern because of the enormous wave of liability that has come with it. Unlike other churches or church entities, several archdioceses and dioceses suddenly have an unprecedented amount of potential debt. Bankruptcy is generally viewed as a way to walk away from one's debt, but bankruptcy need not always have this effect. Rather than disavowing a

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<sup>66</sup> For a criticism of the limitations placed on damages in *A.H. Robins Co. v. Piccinin*, see, for example, RICHARD B. SOBOL, *BENDING THE LAW: THE STORY OF THE DALTON SHIELD BANKRUPTCY* 197–208 (1991).

<sup>67</sup> 11 U.S.C. § 1126 (approval of a majority in number and two-thirds in amount constitutes approval by a class of creditors).

church's liability to victims of clergy sexual misconduct, bankruptcy could also be used as a context for paying them—for confirming the church's accountability rather than undermining it.