

COVID-19, BANKRUPTCY, AND RELIGIOUS INSTITUTIONS

According to Gallup polling, roughly half of Americans reported belonging to a church, synagogue, or a mosque in 2018. Two decades earlier, that number was 70%. Among Christians, mainline congregations, such as the United Methodist Church and the Presbyterian Church (USA), have suffered steep declines since the 1970's.

In that context, the closing of church buildings to live, in-person worship services due to the COVID-19 pandemic has had a dramatic effect on church finances. As if it couldn't be worse, the timing of the pandemic was particularly cruel, closing churches at Easter, when pews – and offering plates – are usually overflowing.

The COVID-19 pandemic will surely lead to a large number of business and individual bankruptcy filings, but what about churches? How can religious institutions utilize the Bankruptcy Code to reorganize their financial affairs?

First, the filing of bankruptcy cases by religious institutions has become far more common and accepted in the last 10-15 years as individual churches and, notably, Roman Catholic dioceses, have pursued bankruptcy in order to address the claims of victims of clergy abuse.

The goals of such filings are similar in many respects to the goals of business filings: the aggregation of numerous claims of creditors into one forum (avoiding a rush to the courthouse where only the swiftest creditors will obtain a disproportionate payout) and the preservation of the business/institution, itself.

Second, the Bankruptcy Code applies to religious institutions in much the same way as it does to businesses. There are some significant differences, however.

- ❖ The Bankruptcy Code permits the filing of a bankruptcy petition by a “corporation.” This does *not exclude* churches because “corporations” may include both non-profit corporations and unincorporated associations.
- ❖ Unlike business entities, however, unpaid creditors cannot force a church into a bankruptcy case. An “involuntary” bankruptcy case may be initiated by creditors, subject to certain requirements as to the number of creditors and their claims, but a religious institution bankruptcy may only be commenced by the institution voluntarily.
- ❖ As with business cases, all of the property of the debtor/church becomes property of a bankruptcy estate administered under the Bankruptcy Code and subject to rulings on disputes by a Bankruptcy Judge. *However*, that property does not include property held in trust for another. This becomes important in the context of a church’s stewardship of funds pledged for a particular beneficiary.
- ❖ Many business bankruptcy cases conclude with a sale of the debtor’s assets to maximize their productive use and a return the creditors. The liquidation or sale of a non-profit’s assets, however, are often regulated by state law and subject to the oversight of state attorneys general. The Bankruptcy Code honors this scheme, so the sale of assets will necessarily have to include approvals from state agencies as would be the case outside of bankruptcy.
- ❖ As with business bankruptcy cases, the ultimate goal is the confirmation of a plan that reorganizes the financial affairs of the debtor. Some of the requirements for confirmation of such a plan do not apply in the non-profit context, however.
 - Very broadly, shareholders of a for-profit company may not retain their shares and force a plan on creditors if creditors are not paid in full. That rule simply doesn’t apply if there are no shareholders. In a church with a board

- of trustees, the trustees do not have to give up their control of the institution even if creditors are not paid in full.
- Plus, because a religious institution has an intrinsic and hard-to-calculate value to a community, confirming a plan can be easier because (1) objections as to the value being offered to creditors are limited by the nature of the assets [the market for baptismal fonts is rather small] and (2) banks and Bankruptcy Judges are cognizant of the public perception resulting from the financial destruction of a church/synagogue/mosque.

 - ❖ The voluntary nature of offerings in most churches creates a significant wildcard. Unlike a business that can tinker with supply chain costs, marketing, or the margin on delivered goods and services, such tweaks may have no effect on the amount of money voluntarily dropped in the offering plate by parishioners.

A Chapter 11 case can be effective in preserving an institution that many believe is an essential part of a community. While Chapter 11 was always available for houses of worship, the impact of the pandemic will be particularly harsh for institutions that rely on voluntary contributions that are often the result of in-person appeals and programs.

Please feel free to contact your Momkus LLC attorney with questions or concerns. Our office is operating at 100% and we've been designated as an "essential service" during the crisis; your calls and emails will receive prompt attention, even if we can't personally shake your hand.