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DEBARRING FAITHLESS CORPORATE AND RELIGIOUS FIDUCIARIES IN BANKRUPTCY

LYMAN JOHNSON*

"The only way to do it is take away their livelihood . . . ."+
Former University of Florida football coach Urban Meyer

INTRODUCTION

The highest officials in both business and religious organizations must be faithful to the institutions they oversee. This obligation finds legal expression in fiduciary duties and is rooted in shared social-moral understandings that, for many, originate in religious teachings.[1] The duty of faithfulness, historically and doctrinally, has been phrased in seemingly strict and demanding terms.[2] Meaningful sanctions for breaching this stricture, however, are difficult to obtain, and may not deter high level misconduct, including the kind of conduct leading to organizational bankruptcy.[3] The result is that faithless fiduciaries not only frequently escape personal liability for wrongdoing; they are free to repeat their mismanagement elsewhere.

This article argues that, under specified conditions, bankruptcy courts should be empowered to debar faithless fiduciaries from holding certain leadership positions, or engaging in certain behavior, post-bankruptcy. The power to debar, whether for a brief or lengthy period, theoretically would extend to governing officials in business, secular nonprofit, and religious organizations, although First Amendment concerns raise grave (but debatable) doubts about debarment relief in the latter setting, thereby sharply juxtaposing what law can do to deter faithlessness in secular and ecclesiastical venues. The authority to debar would be triggered by behavior that currently may escape sanctioning by state law fiduciary duties, and would extend to those highest officials who were "substantially responsible" for the failed condition of the bankrupt organization. The focus of a debar order is not remedial

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+ Pete Thamel, *College Football's Ugly Season, Facing Scandals of Every Stripe*, N.Y. TIMES, Aug. 21, 2011, at A1, A16. Mr. Meyer was commenting on how to stop college football coaches from violating NCAA rules–suspend them from coaching..

[1] *See infra* Part II.A.2.

[2] *See infra* Part II.A.2.

[3] *See infra* Part II.A.2, B.

but would be forward looking, and would aim to achieve deterrence by outright prohibition.

Part II of this article describes how faithfulness should be the central and overarching obligation of fiduciaries, including leaders of business, secular nonprofit, and religious organizations. The duty of faithfulness is both a legal stricture and one that, using the Christian religious tradition as just one example, comports with biblical teachings. Yet secular state law often does not meaningfully sanction past breaches of duty or effectively deter future misconduct. Part III describes how several non-bankruptcy legal regimes rectify this shortcoming by permitting entry of debarment orders under state and federal law. These regimes can serve as a source of guidance for fashioning debarment relief in bankruptcy.

Part IV advocates debarment authority in bankruptcy through an amendment to the Bankruptcy Code. The various reasons for permitting debarment relief in a bankruptcy proceeding will be developed, and the conditions to and permissible scope of a debarment order will be described. Possible objections to and legitimate concerns about debarment relief—particularly in religious organizations—will be considered. As noted in Part IV, some guidance on the degree to which secular law can regulate the internal governance of religious organizations can be expected from a case before the United States Supreme Court during its October 2011 term.

The overall aim of this article is to offer fresh thinking on three issues at the intersection of bankruptcy, organizational governance, religion, and constitutional law. First, a bankruptcy proceeding need not be only a standalone, single-company endeavor, but should, in some instances, take note of how other companies might be affected in the future by the same kind of fiduciary wrong doing seen in the bankrupt company. Second, bankruptcy law should not have only a remedial financial focus but should, in part, and under certain circumstances, have a deterrent governance thrust. Third, the ability of law—in or out of bankruptcy—to deter governance wrongdoing in religious organizations is exceedingly limited, in comparison to business and secular nonprofit organizations, although the scope of secular immunity for harm-causing, high-level ecclesiastical officials is far from clear. Faithfulness in the ecclesiastical setting might best be achieved by other means.

I. DEMANDING FAITHFULNESS WITH WEAK SANCTIONS

A. The Seeming Strength of the Faithfulness Norm

The concept of faithfulness is a rich, evocative term with currency both in the legal sphere and in the social-moral-religious realm. This point will be made, briefly, by looking at contemporary corporate law and at the ancient teachings of one faith tradition, Christianity.

1. Fiduciary Duties

Legally, the highest decision makers in business organizations—i.e., directors and executive officers—are subject to the fiduciary duties of loyalty and care.[4] This generally is the case as well in non-profit organizations,[5] although the law pertaining to governing officials of religious organizations, specifically, is less developed on this point. An excellent illustration of how faithfulness pertains to legal duties is seen in a 2005 post-trial opinion in the high-profile *In re Walt Disney Co. Derivative Litigation.*[6] In explicating the duties of care and loyalty, Chancellor William Chandler of the Delaware Court of Chancery repeatedly invoked the words "faithful" and "faithfulness," terms laden with a demanding moral tenor.[7]

Chancellor Chandler's lengthy introduction, for example, used the words "faithful" or "faithfully" five times,[8] once as part of the phrase, biblical in origins, "faithful servants."[9] In exploring how the ill-defined concept of "good faith" related to the fiduciary duties of loyalty and care, Chandler recast the latter duties as

> but constituent elements of the overarching concepts of allegiance, devotion and faithfulness that must guide the conduct of every fiduciary. The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, in the narrow sense . . . , but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders.[10]

The Delaware Supreme Court prominently quoted this language in affirming the Chancellor's decision.[11] Moreover, numerous earlier Delaware opinions had

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[4] *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 (Del. Ch. 2005), *aff'd,* 906 A.2d 27 (Del. 2006); *see also* MODEL BUS. CORP. ACT §§ 8.30-8.31 (2010) (providing standards of conduct and standards of liability for corporation directors).

[5] MODEL NONPROFIT CORP. ACT §§ 8.30–31 (2008) (providing standards of conduct and standards of liability for directors); *see also* Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance – A Comprehensive Look at Nonprofit Directors' Fiduciary Duties,* ___ U. PA. J. BUS. L. – (forthcoming 2011). Although directors of organizations formed as corporations have specified duties, members of governing bodies of groups organized in non-corporate form (whether a board of elders or trustees or a parish council or a presbytery, and so on) also likely owe fiduciary duties. It is less clear, however, that members of the clergy can be said to owe fiduciary duties, in their capacity as clergy, to a congregation or to parishioners. *See, e.g.,* Maffei v. Roman Cath. Archbishop of Bos., 867 N.E.2d 300, 306 (Mass. 2007) (holding no legal fiduciary duty of priest to congregation). To the extent a clergy member interacts with third parties, however, he or she is an agent of the organization, and agents owe fiduciary duties. Moreover, to the extent such a clergy member serves on a governing body of a church—e.g., as a director of a nonprofit corporation—fiduciary duties would be owed for actions taken in that capacity.

[6] 907 A.2d 693 (Del. Ch. 2005), *aff'd,* 906 A.2d 27 (Del. 2006).

[7] *In re Walt Disney,* 907 A.2d at 697–99.

[8] *Id.*

[9] *Id.* at 698; *see Matthew* 25:21, 23 (using the phrase "faithful servant" twice). The author is not suggesting that Chancellor Chandler deliberately invoked a scriptural passage. Rather, the point is that that scriptural passage is so commonplace in everyday and professional discourse that its origins are rarely considered.

[10] *In re Walt Disney,* 907 A.2d at 755.

[11] *See In re Walt Disney,* 906 A.2d at 67.

similarly invoked the concept of faithfulness as central to fiduciary duty.[12] For all the attention given in recent years to the economics of fiduciary duties,[13] legal doctrine in that area continues to be couched in a decidedly moral grammar.

2. Biblical Teaching

In several places, the Christian Bible commands the quality of faithfulness in tending to the affairs of others. In Jesus' Parable of the Shrewd Manager,[14] in his Parable of the Talents,[15] and in his story of the faithful servant,[16] Jesus makes clear that when working for another, or when entrusted with another's property, "faithfulness" is required. His famous teaching on a servant being unable to serve two masters[17]—a passage regularly cited by judges into the twentieth century[18]—immediately follows a strong teaching on the quality of honest faithfulness that underlies the narrower behavioral proscription on conflicting loyalties.[19] This religio-historical antecedent nicely corresponds to Chancellor Chandler's subsuming of loyalty within an overarching secular conception of faithfulness.[20]

For purposes of this article, it is interesting to note how, in Christ's parables, he describes the outcome of *faithlessness*, the opposite of faithfulness. In the Parable of the Talents,[21] after the master in that story praises the first two faithful servants with the phrase "[w]ell done, good and faithful servant,"[22] he turns to the third, lazy servant. After severely rebuking him,[23] the master orders that the talent that had been entrusted to him be taken away and that the servant be thrown outside.[24] In other words, the servant lost his current position and was barred from further service. And we see this as well in the Parable of the Shrewd Manager, where a rich man's manager who had committed waste was ordered to give an account "because you cannot be manager any longer."[25] He was barred, in other words. The rationale for this response was provided: "And if you have not been trustworthy

[12] *See, e.g.*, Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1048–49 & n.16 (Del. 2004); Baring v. Condrell, No. Civ.A. 516-N, 2004 WL 2340047, at *2 (Del. Ch. Oct. 18, 2004); Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. Civ. A. 20228-NC, 2004 WL 1949290, at *17 (Del. Ch. Aug. 24, 2004); Guttman v. Huang, 823 A.2d 492, 506 & nn.34–35 (Del. Ch. 2003); *In re* Caremark Int'l. Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

[13] The seminal work is Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

[14] *Luke* 16:1–13.

[15] *Matthew* 25:14–30; *see also Luke* 19:11–27 (parable of ten minas).

[16] *Luke* 12:35–48.

[17] *Id.* at 16:13.

[18] Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 53 n.150 (2003).

[19] *Luke* 16:10–12.

[20] *See supra* note 9 and accompanying text.

[21] *See supra* note 15.

[22] *Matthew* 25:21, 23; *see also supra* text accompanying note 9.

[23] *Id.* at 25:26–27 (renouncing servant as wicked and lazy).

[24] *Id.* at 25:28–30.

[25] *Luke* 16:2.

with someone else's property, who will [in the future] give you property of your own?"[26]

The command of faithfulness therefore is forcefully articulated in both human law and in biblical teaching. It likely finds expression in other religious and moral traditions as well. Moreover, in biblical teaching there is severe, forward-looking sanctioning of faithless conduct. It turns out, however, that meaningful sanctions for breaching legal duties within a corporation are much harder to obtain.

B. Weak Legal Sanctions

With respect to all organizations formed under state law, the fiduciary duties of those who direct or manage their affairs are governed by state law fiduciary duties, both before and during bankruptcy.[27] Most top-level business managers are replaced right before or right after a bankruptcy filing,[28] but whoever manages a bankrupt organization continues to owe state law fiduciary duties. As will be described below, however, notwithstanding the seemingly strict expression of those duties noted above, it is exceedingly difficult to sanction high-level decision makers for conduct leading to an organization's financial distress. The perception of low personal risk for financial failure (asymmetrically coupled with substantial incentives for financial success)—i.e., personal upside but no personal downside—can itself heighten organizational risk.[29]

Starting with the duty of care, Delaware, the leading corporate law jurisdiction, has established a loose gross negligence standard as the benchmark for assessing director conduct.[30] Moreover, this deferential measure has been interpreted as imposing, essentially, a recklessness standard.[31] In addition, since 1986, Delaware has permitted a corporation's certificate of incorporation to exculpate (or absolve)

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[26] *Id.* at 16:12. Of course, there are a range of Christian views on the morality of bankruptcy itself, a subject this article does not address. *See, e.g.*, G. Jeffrey MacDonald, *The Moral Burden of Bankruptcy*, CHRISTIAN SCI. MONITOR (July 3, 2006), *available at* http://www.csmonitor.com/2006/0703/p13s01-lire.html (weighing Christian views of both sides of debate over morality of bankruptcy).

[27] The Bankruptcy Code does not expressly refer to the Debtor in Possession (DIP) as a fiduciary but, as with a chapter 11 trustee, case law treats the managers of the DIP in that manner. *See* Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 486–87 & nn.77–78 (2011) (citing case law holding directors of DIPs have fiduciary duties to creditors and shareholders). For a business corporation, the board of directors and officers would continue to govern the business, while for a religious organization, the governing official or body would be that provided for in the organization's governance system, be that a board of directors/elders/trustees or bishop, etc., as the case may be.

[28] *See* A. Mechele Dickerson, *Privatizing Ethics in Corporate Reorganizations*, 93 MINN. L. REV. 875, 915 (2009) (providing examples of high profile bankruptcy filings where top-level officers were replaced upon filing).

[29] *See* Robert T. Miller, *Oversight Liability for Risk-Management Failures at Financial Firms*, 84. S. CAL. L. REV. 47, 104 (2010) (discussing directors' lack of incentive to better manage risk taking due to exculpation of directors' personal liability in many Delaware corporations' articles of incorporation).

[30] *See e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[31] McPadden v. Sidhu, 964 A.2d 1262, 1274 (Del. Ch. 2009) (defining gross negligence as "reckless indifference," or actions without reason).

directors of any personal monetary liability for breaching the duty of care.[32] Furthermore, care is wholly a process-oriented duty; there is no substantive dimension.[33] Therefore, even a colossally stupid business decision—or recklessness in oversight—that causes the financial downfall of a company is not, taken alone, actionable in a way that will lead to a monetary recovery.[34] In addition, heightened pleading standards, after the *Twombly* and *Iqbal* decisions,[35] also make surviving a motion to dismiss, in or out of bankruptcy, more difficult.[36] The upshot is that it is extremely unlikely that a corporate director will be sanctioned for breaching the fiduciary duty of care.

As to the duty of loyalty, the prospects for legal sanction are greater, but only in somewhat narrow circumstances.[37] A director who has a traditional conflict of interest, wherein he or she unfairly benefits at the expense of the organization, must answer for the breach,[38] typically by making restitution, a remedy not serving as much of a deterrent since ill-gotten gain is simply returned.[39] As to loyalty claims not involving such conflicts, a director will be personally liable only if he or she willfully or deliberately engaged in wrongful conduct.[40] Gross (reckless) neglect of or inattention to oversight duty is not a loyalty breach.[41] As in the duty of care setting, stupendously wrong-headed or foolish business decisions, taken alone, do not constitute breaches of the duty of loyalty, even if they bankrupt a company.[42] Consequently, unless there is personal wrongful gain or deliberate misconduct,

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[32] DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).

[33] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (holding concept of substantive due care "foreign" to business judgment rule).

[34] *See, e.g., In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 122, 124 (Del. Ch. 2009) (quoting *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967–68 (Del. Ch. 1996)) (explaining judges and juries are "ill-equipped" to evaluate substance of directors' business decisions and accordingly, business judgment rule is process-oriented).

[35] Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949–50 (2009) (adopting Twombly's strict pleading standard); Bell Atl. Corp. v. Twombly, 550 U.S. 544, 562–63 (2007) (rejecting low pleading standard set forth in Conley v. Gibson, 355 U.S. 41 (1957)).

[36] Todd R. David et al., *Saving Failed Biz Insiders From Fiduciary Duty Claims*, LAW360 (Apr. 12, 2011), http://www.law360.com/articles/237901 (examining recent cases). *But see* Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 537 (Del. 2011) (refraining from addressing *Twombly-Iqbal* standard because issue was not fully litigated and adhering to traditional Delaware standard of reasonable "conceivability").

[37] Delaware law does not permit exculpation of directors for breaching the duty of loyalty. DEL. CODE ANN. tit. 8, § 102(b)(7) ("[The certificate of incorporation] shall not eliminate or limit the liability of a director . . . [f]or any breach of the director's duty of loyalty to the corporation or its stockholders . . . .").

[38] *See Id.* (stating director liability cannot be eliminated "for any transaction form which the director derived an improper personal benefit"); *see also* Johnson, *supra* note 18, at 30–33 (discussing development of § 102(b)(7) of the Delaware Code).

[39] *But see* D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1496 (2002) (finding restitution "well-suited to achieving the goal of deterrence that animates fiduciary duty").

[40] *See* Stone v. Ritter, 911 A.2d 362, 367, 370 (Del. 2006).

[41] *See id.* at 370 (holding bad faith conduct is essential to establish oversight liability).

[42] *See* Kaye v. Lone Star Fund V (U.S.), L.P., 453 B.R. 645, 678 (N.D. Tex. 2011) (asserting "mere fact" decision caused company to suffer some loss does not amount to breach of fiduciary duty "unless the decision is outside the bounds of any rational business purpose").

directors do not face the prospect of legal sanctions on the loyalty front, even where this leads to an organization's failure.[43]

For corporate officers, there is greater likelihood of personal liability because, in Delaware at least, officers cannot be exculpated.[44] Moreover, it is not yet clear what the Delaware standard of care is for officers,[45] gross negligence only, as with directors, or simple negligence. Still, given that most misbehaving officers, upon departing, "settle up" with directors in a way that likely involves a mutual release of claims,[46] they too infrequently face the prospect of paying money damages for their wrongdoing, although to be sure, their exposure is greater than that of directors.[47]

Even if one believes that fiduciary duties are legally calibrated as they should be on the personal liability issue, two nagging questions arise nonetheless. First, does the lack of meaningful legal sanctions for directors (or other organizational overseers) sufficiently deter them from routinely failing to discharge their duties, even to the point of risking organizational bankruptcy? Second, even if fiduciaries are not answerable for damages for past misconduct, is there a way to prevent such faithless stewards from repeating their mistakes at the expense of another organization in the future? This is where the possibility of debarment relief comes in.

II. DEBARMENT ORDERS OUTSIDE BANKRUPTCY

Several federal administrative agencies already are authorized to seek court debarment orders or impose such orders themselves. These agencies include the Food and Drug Administration,[48] the Environmental Protection Agency,[49] the

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[43] *See, e.g., In re* BH S & B Holdings LLC, 420 B.R. 112, 150 (Bankr. S.D.N.Y. 2009) ("A breach of loyalty claim requires some form of self-dealing or misuse of corporate office for personal gain." (quoting CVC Claims Litig. LLC v. Citicorp Venture Capital Ltd., No. 03 Civ. 7936(DAB), 2007 WL 2915181, at *3 (S.D.N.Y. Oct. 3, 2007))).

[44] Gantler v. Stephens, 965 A.2d 695, 709 n.37 (Del. 2009) (noting absence of statutory provision authorizing exculpation of officers from monetary liability for breach of duty of care in Delaware). Certain states do permit exculpation of officers. *See, e.g.*, VA. CODE ANN. § 13.1-692.1 (West 2010) (permitting exculpation of both officers and directors).

[45] Lyman Johnson & Dennis Garvis, *Are Corporate Officers Advised About Fiduciary Duties?*, 64 BUS. LAW. 1105, 1108 (2009) (stating "area of officer duties remains murkier than that of director duties").

[46] Lyman Johnson & Robert Ricca, *Reality Check on Officer* Liability, 67 BUS. LAW. (forthcoming 2011) (positing judges will "rarely have to make the determination as to whether an officer did or did not behave negligently" because directors generally discharge, rather than sue, officers).

[47] Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597, 1603 (2005) (stating officers, as agents, have fiduciary duties more demanding than those of directors and thus "rightly face a greater risk of personal liability for misconduct").

[48] Federal Food, Drug, and Cosmetic Act § 306, 21 U.S.C. § 335a (2006) (mandating Secretary of Health and Human Services debar those individuals convicted of felony for conduct relating to development or approval of drug application). As of October 12, 2011, the FDA website listed 103 persons who had been debarred since 1993. *FDA Debarment List (Drug Product Applications)*, http://www.fda.gov/ICECI/EnforcementActions/ FDADebarmentList/default.htm.

[49] *See* 40 C.F.R. § 26.1506 (2011) (proscribing debarment as remedy for violation of regulations); *see, e.g.*, PPI Aerospace, Inc., EPA S. 01-0185-00A, 2005 WL 5163071 (EPA GD), at *9 (Nov. 22, 2005) (ordering one year debarment).

Defense Department,[50] the Commodity Futures Trading Commission,[51] and the Securities and Exchange Commission ("SEC").[52] The conditions for imposing bar orders vary from one regulatory regime to another. Recently, bar orders, although deployed for many years, have drawn new attention as part of "a larger Obama administration effort to pursue individual executives blamed for wrongdoing rather than simply punishing companies."[53] When a company is in bankruptcy, moreover, government efforts to impose monetary sanctions on financially distressed corporations themselves can reduce the dollar amount of assets available for other creditors, whereas debarment actions against directors and officers do not have that effect.[54]

Perhaps the agency best known for its bar orders is the SEC. Because its legislative mandate has permitted the SEC since 1990 to bar, specifically, corporate directors and officers[55]—the focus of this article—a brief description of that agency's debarment power is provided here.

When first granted the power to suspend or bar public company directors and officers from future service in those capacities, conditionally or unconditionally and permanently or for a shorter period, the SEC had to go to court to procure a bar order.[56] The original statutory grounds were "substantial unfitness" to serve in the future because of a prior violation of section 17(a)(1) of the Securities Act or section 10(b) of the Exchange Act.[57] Each of these sections requires scienter, i.e., willful or reckless conduct.[58] The Sarbanes-Oxley Act in 2002 altered the standard

[50] *See* 2 C.F.R. § 1125 (2011) (establishing process for debarment); *see also* 10 U.S.C. § 2393 (Supp. 2011) (explaining military secretary cannot subcontract with contractor debarred by another Federal agency); 32 C.F.R. § 32.13 (2008) (stating debarment has effect on contractual relations).

[51] *See* 7 U.S.C. § 12a(2) (2006) (stating Commission may refuse to register or restrict registration of person for various reasons); *see, e.g.*, Consent Order of Permanent Injunction and for other Equitable Relief Against Defendants Enrique F. Villalba and Money Market Alternative, LP, Commodity Futures Trading Comm'n v. Villalba, No. 1:10-cv-0647-DDD (N. D. Ohio Jun. 2, 2011) (barring from commodity futures market investment adviser who ran Ponzi scheme).

[52] *See infra* note 56 (detailing SEC's authorization to seek debarment against directors and officers).

[53] Alicia Mundy, *U.S. Effort to Remove Drug CEO Jolts Firms*, WALL ST. J. (Apr. 26, 2011), *available at* http://online.wsj.com/article/SB10001424052748704123204576283283851626952.html.

[54] *See* Kelli A. Alces, *Limiting the SEC's Role in Bankruptcy*, 18 AM. BANKR. INST. L. REV. 631, 640 (2010) (noting this point for money sanctions, not debarment relief).

[55] The SEC, even before 1990, had the power to bar brokers, investment advisors, and investment company managers. *See* Jayne W. Barnard, *SEC Debarment of Officers and Directors After Sarbanes-Oxley*, 59 BUS. LAW. 391, 409 & n.123 (2004).

[56] *See* 15 U.S.C. § 77t(e) (2006) (Securities Act of 1933) (supplying court with power to prohibit violators of section 77q(a)(1) from acting as officers or directors); 15 U.S.C. § 78u(d)(2) (2006) (Securities Exchange Act of 1934) (arming court with power to prohibit violators of section 77j(b) from acting as officers or directors). Prior to enactment of these provisions, a court likely had inherent equity power to enjoin service as an officer or director but such orders were rare. *See, e.g.*, SEC v. Drexel Burnham Lambert Inc., 837 F. Supp. 587, 589 (S.D.N.Y. 1993) (illustrating situation in which SEC sought court ordered debarment as equitable remedy), *aff'd sub nom.* SEC v. Posner, 16 F.3d 520, 521 (2d Cir. 1994) (enjoining Victor Posner).

[57] *See Drexel Burnham Lambert Inc.*, 837 F. Supp. at 613.

[58] *See, e.g.*, Aaron v. SEC, 446 U.S. 680, 695, 697 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197, 201 (1976).

to that of "unfitness,"[59] and provided that the SEC may enter a bar order in its own cease-and-desist administrative law proceeding rather than go to court.[60]

For several years after passage of Sarbanes-Oxley, the SEC continued, for the most part, to seek bar orders in federal court, not in administrative proceedings.[61] The overall use of bar orders increased greatly, however.[62] A recent study, for example, reveals that a significant percentage (39%) of CFOs who are charged with wrongdoing by the SEC are charged in an administrative proceeding and that, when legal penalties are imposed on CFOs, a bar order is imposed in more than 54% of all cases.[63] The SEC also has shown an increased interest in imposing time-limited bars, typically for five years, not simply permanent bars.[64]

In short, bar orders play a key role in the sanctioning powers of many federal agencies. Debarment orders are also available under state law, for directors of both for-profit and nonprofit organizations,[65] although they are used far less often than under federal administrative law. Section 8.09(a) of the Model Nonprofit Corporation Act permits a court to remove a director for having "grossly abused" his or her position as a director if, considering the adequacy of other remedies, removal is in the best interests of the corporation.[66] Moreover, section 8.09(c) of that Act authorizes a court to bar a removed director from being reelected or reappointed.[67] This section makes no exception for religious organizations, although in numerous other sections the Model Act crafts special provisions for these types of corporations.[68] As discussed below,[69] applying section 8.09 to a

[59] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 305(a), 116 Stat. 745, 778–79 (2002) (replacing "substantial unfitness" standard with "fitness" standard in Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 § 21(d)(2) (codified as amended at 15 U.S.C. § 78u(d)(2) (2006)) and Securities Act of 1933, ch. 38, 28 Stat. 74 § 20(e) (codified as amended at 15 U.S.C. § 77t(3) (2006))).

[60] *See id.* § 1105, 116 Stat. at 809–10 (adding Securities Act § 8A(f) (codified as amended at 15 U.S.C. § 77h-1(f) (2006) and Securities Exchange Act § 21C(f) (codified as amended at 15 U.S.C. § 78-u-3(f) (2006))).

[61] *See* Stephen J. Crimmins, *Where Are We Going With SEC Officer and Director Bars?*, 38 BNA SEC. REG. & L. REP. 717, 718 (Apr. 24, 2006) (documenting SEC's authority to impose officer and director bars has gone unused in favor of judicial proceedings).

[62] *See id.* at 719 (commenting on increase in SEC officer and director bars from 38 to 170 between 2000 and 2003).

[63] *See* Mei Feng et al., *The Role of CFOs in Material Accounting Manipulations*, THE CONF.BOARD, May 2011, at 4, *available at* http://www.conference-board.org/publications/publicationdetail.cfm?publicationid=1938. The study examined charges against CFOs from May 17, 1982 through June 10, 2005.

[64] *See* Crimmins, *supra* note 61, at 721 & nn. 36–37 (mentioning several cases in which time restricted bars were imposed).

[65] *See, e.g.*, MODEL BUS., *supra* note 4, at § 8.09(c) (describing court procedure for removing and debarring directors); MODEL NONPROFIT, *supra* note 5, at § 8.09(c) (giving court authority to remove and debar directors).

[66] MODEL NONPROFIT, *supra* note 5, at § 8.09(a).

[67] *Id.* at § 8.09(c).

[68] *See, e.g.*, *id.* at §§ 1.60, 8.05, 8.30(f)(4), 14.32(f). Section 1.60, moreover, specifically provides that religious doctrine or canon law, if inconsistent with the provisions of the Act, will control to the extent required by the U.S. Constitution or the applicable state constitution. Also, the official comment to section 1.50 states that it is "expected . . . that courts will use their discretion to avoid becoming overly entangled in the affairs of religious corporations." *Id.* at § 1.50.

director/trustee/elder of a religious organization might be highly suspect on First Amendment grounds.

Debarment relief has the advantage of sanctioning misconduct while not depleting the financial resources of companies themselves, whose investor and creditor constituencies may be unaware of and innocent of wrongdoing. This is of particular importance if the misconduct created significant financial distress for the business because government monetary penalties could crowd out private claimants. And, unlike the case with money damages or civil penalties, bar orders are entirely forward looking and can pointedly seek to prevent repeat behavior in a specified setting. But should they be used against high officials in business, much less religious, organizations whose behavior contributed to bankruptcy?

III. DEBARMENT ORDERS IN BANKRUPTCY

A number of issues must be addressed in considering debarment orders in bankruptcy. These include: Why is debarment relief in bankruptcy a good idea and what underlying behavior/legal violation by an officer/director/trustee/elder should be the predicate offense? What standard—if different than the predicate wrongdoing itself—must be met to warrant debarment and, if met, what range of relief might be granted? What concerns and objections might be raised, including whether debarment is consistent with the purpose of bankruptcy, and who in the bankruptcy system would be able and motivated to pursue debarment relief? And how might First Amendment concerns bear on debarment orders in the religious organization context? These will be addressed in order.

A. The Need and Predicate for Debarment Relief

Currently, an individual bankruptcy debtor who has significantly breached a fiduciary duty or violated federal or state securities laws may not discharge any debt arising from that misconduct.[70] A person who breaches a fiduciary duty owed to an organizational bankrupt debtor—but who does not himself or herself enter bankruptcy—continues to face the possibility of personal liability for that breach[71] but, as noted in Part II, the likelihood of meaningful exposure, particularly for outside directors, is very small. Thus, post-bankruptcy, the likelihood of future sanctioning is remote. Moreover, whether or not a fiduciary for an organization declares personal bankruptcy, he or she is not prohibited from assuming the same or a similar position as that in which he or she first breached a duty, however egregious or harm-causing the breach may be. In short, they can do it again.

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[69] *See infra* Part IV.D.

[70] *See* 11 U.S.C. § 523(a)(4), (6), (19) (2006) (listing fraud, willful or malicious injury, and violations of securities laws as exceptions to discharge).

[71] *See* Leblanc v. Salem (*In re* Mailman Steam Carpet Cleaning Corp.), 196 F.3d 1, 6 (1st Cir. 1999) (acknowledging it is settled that trustees can be held personally liable for a breach of the duty of loyalty).

Business and religious organizations face bankruptcy for many reasons. At the bottom of these varied stories of financial distress lies, in many instances, a failure of governance.[72] For a church, such as with the Catholic Church, bankruptcy may stem from widespread, and long ignored, abuse by clergy that results in crippling financial liability from victims' suits.[73] Or, clergy or other fiduciaries may embezzle, misuse or illegally "launder" funds.[74] From an organizational governance perspective, the vital question is: Who misgoverned the church or other religious entity to permit this devastation? In the more common business failure setting, catastrophic losses may result from poor risk management practices or from business strategies that ignored obvious or detectable dangers.[75]

For those fiduciaries who willfully and deliberately engaged in misconduct—as with abusive priests or disloyal self-dealing executives—breach of fiduciary duty is clear and should create personal liability to the organization itself for harm caused.[76] Where persons in a more supervisory role are involved, however, such as church bishops or a lay parish council or directors/trustees/elders, as the ecclesiastical case may be, it is far less clear that they intentionally misbehaved. Thus, however derelict they may be in a normative sense, they likely did not breach the legal duty of loyalty.[77] Consequently, in being neglectful or careless or reckless, they were faithless institutional stewards,[78] but, legally, it is highly unlikely that they will face personal liability for their deficient oversight.[79]

A prime example of such faithlessness comes from the staggering losses experienced by some of our country's largest financial institutions, such as AIG,

[72] *See, e.g., In re* Roman Cath. Archbishop of Portland in Or., 335 B.R. 815, 825–26 (Bankr. D. Or. 2005) (stating evidence of churches' governance policies in response to allegations of sexual misconduct against priests is relevant to determining churches' liability); Jill S. Manny, *Governance Issues For Non-Profit Religious Organizations*, 40 CATH. LAW. 1, 1 (2000) (discussing diocese's attempts to cover up scandal involving its priests that lead court to hold diocese liable for damages in excess one-hundred million dollars).

[73] *See* Jonathan C. Lipson, *When Churches Fail: The Diocesan Debtor Dilemmas*, 79 S. CAL. L. REV. 363, 363 (2006) (describing bankruptcies of several Catholic dioceses in Washington, Arizona, and Oregon due to claims for priests' sexual misconduct). Recently, a Catholic bishop and the diocese he leads were criminally indicted for allegedly covering up abuse by a priest that was known to the bishop. A. G. Sulzberger & Laurie Goldstein, *Catholic Bishop Charged In Priest Abuse Case*, ST. PAUL PIONEER PRESS, Oct. 15, 2011, at A2. To be sure, other religious institutions also have experienced similar scandals. *See* Lipson, *Supra* at 370 & n.32. And secular nonprofit institutions also can be devastated, reputationally, by child abuse scandals, as recently seen in the case of Penn State. Kris Maher, *Push to Toughen Abuse Law*, WALL ST. J., Nov. 14, 2011, at A3.

[74] *See* Pete Brush, *NY Rabbi Admits to Laundering Conspiracy*, LAW360 (Apr. 08, 2011, 4:10 PM), http://www.law360.com/articles/237857/ny-rabbi-admits-to-laundering-conspiracy (describing illegal money laundering scheme); *see also infra* notes 176–84 and accompanying text (describing mismanagement by founder-directors of various Christian ministries).

[75] *See* In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968 (Del. Ch. 1996) (listing companies who have experienced significant financial harms and losses due to poor corporate governance and monitoring programs).

[76] *See supra* notes 40–41 and accompanying text.

[77] *Id.*

[78] Recall that in the Parable of the Talents, the third servant was deemed faithless—and banished—not for outright disloyalty but for laziness. *See supra* notes 21–24 and accompanying text.

[79] *See supra* notes 32–36 and accompanying text.

Bear Stearns, Lehman Brothers, Citigroup, Bank of America, and so on.[80] Although many companies were spared formal bankruptcy due to the federal government bailout,[81] colossal losses to creditors and investors were not averted. Yet, when, for example, the directors of Citigroup were sued for breaching their fiduciary duties in not steering that iconic bank to avoid huge losses on complex, rapidly-sinking mortgage loans, the judge emphasized the purely process-oriented nature of the duty of care and dismissed the charges.[82] For a care breach, in other words, stupendously wrong business decisions or persistent strategic blunders simply do not matter.[83] Moreover, even if Citigroup directors had breached the duty of care—by being outright reckless in handling their duties—they would face no personal liability due to permitted exculpation for such breaches.[84] And if Citigroup had entered bankruptcy, the directors could continue on in their positions and/or move to other institutions and recklessly endanger them.

This is disconcerting given that directors, legally, are responsible for an organization's overall risk management,[85] are to be skeptical of management's rosy predictions, should monitor industry conditions or retain disinterested advisers who will do so, and should not assume that management-devised strategies are, or under changing conditions remain, the best course of action. It is far from clear that directors and officers at many financially distressed companies fully discharged their governance and oversight responsibilities in recent years. For example, the former CEO of Merrill Lynch stated that even its full-time executives (much less its outside directors) did not understand the perilous positions it was taking prior to that firm's collapse.[86] Professor Alan Blinder, moreover, has observed that "many

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[80] *See In re* Wilborn, 401 B.R. 848, 856–57 (Bankr. S.D. Tex 2009) (suggesting current financial crisis caused by lack of company oversight and inattention to risk).

[81] Lawsuits over the financial calamity still are proceeding, however. As just one example, a federal judge recently ruled that a consolidated securities class action against two Bank of America officers pertaining to its acquisition of Merrill-Lynch could proceed under federal securities law because scienter was sufficiently pleaded. *In re* Bank of Am. Corp. Sec., Derivative, and Emp. Ret. Income Sec. Act (ERISA) Litig., No. 09 MD 2058(PKC), 2011 WL 3211472, at *9 (S.D.N.Y. July 29, 2011).

[82] *See supra* note 34.

[83] Another example is the decision by top executives at Washington Mutual Bank to make billions of dollars in risky single-family residential loans to spike profits and receive more compensation. Dan Rivoli, *FDIC To Pursue More Cases Against Failed Banks*, LAW360 (Apr. 18, 2011), http:///www.law360.com/articles/239634/print?section=securities. The directors of the bank evidently acquiesced in this business strategy. The FDIC recently sued the officers but, apparently, not the directors. *Id.* Another example—receiving less national attention—but likely typical, involves one of the largest Chevrolet dealers in the country, Bill Heard Enterprises, which filed under chapter 11. The Trustee sued directors and officers for continuing to pursue its long-time high volume business strategy of selling automobiles to subprime borrowers even as the subprime mortgage crisis continued to worsen. Heard v. Perkins, 441 B.R. 701, 703–04 (N.D. 2010). The claim was rejected under Georgia state law because it alleged only incompetence, not malfeasance. *Id.* at 713.

[84] *See supra* note 30–32 and accompanying text.

[85] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968–70 (Del. Ch. 1996) (discussing board's management oversight responsibilities).

[86] *See* Martin B. Robins, *Pay + Board Composition + Personal Behavior ≠ Corporate Governance: In Search of Conceptual Change*, 11 U.C. DAVIS BUS. L.J. 325, 343 & n.60 (2011).

[boards] were asleep at the switch, with disastrous consequences."[87] Investigative journalist Charles Gasparino has offered a litany of scathing governance reviews pertaining to the recent crisis.[88] Of bankrupt Lehman Brothers' CEO, Richard Fuld, Gasparino said: "His board of directors remained silent as his risk taking grew."[89] Of virtually bankrupt Bear Stearns, Gasparino observed: "[T]he board barely debated the firm's risk taking . . . ."[90] And, in describing Merrill Lynch and CEO, Stanley O'Neal, Gasparino says simply: "His board was clueless."[91]

Hindsight, which is eschewed in reviewing fiduciary duty breaches but is wholly legitimate in determining whether someone should continue to serve as a fiduciary, shows that stunningly bad and avoidable decisions obviously were made in high places that were bankruptcy-inducing for numerous organizations, business and religious. When neglect or abdication by fiduciaries leads to bankruptcy, significant costs are imposed on many persons.[92] Given the small likelihood that ill-performing fiduciaries will face personal liability, certain of them should at least be prevented, in fact and symbolically, from repeating their abysmal performance. Numerous persons who fail in some manner may not be held personally liable for all the resulting damage, but often they are precluded from future opportunities. In effect, they are demoted.

In well-performing markets and in organizations with high-functioning governance systems, creditors and/or vote-holders might be relied on to demand or effectuate change. That may not always happen, however, and where wrongdoing is of a certain kind or magnitude, external proscription is appropriate. SEC bar orders are an example of not relying entirely on shareholder suffrage under state corporate law to determine who can serve as a director.[93]

The aim of debarment is not, it bears emphasizing, to impose monetary sanctions and thereby fulfill victim compensation purposes. The goal, rather, is to deter; specifically deter by blocking future service in some manner, and generally deter by inducing other fiduciaries not to mis-perform. For purposes of this article, the predicate misbehavior for debarment would be a breach of the applicable state law duty of care, whether negligence or gross negligence (tantamount to recklessness). This would be a necessary finding for a debarment order but it would not be sufficient, as addressed in the next subsection.

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[87] *Id.* at 356 (alteration in original).

[88] *See, e.g.*, Charles Gasparino, *Don't Blame Hank Greenberg for AIG*, THE DAILY BEAST (Apr. 3, 2009), http://www.thedailybeast.com/articles/2009/04/03/dont-blame-hank-greenberg-for-aig.html (recounting interview with former CEO of AIG about the company's collapse).

[89] Robins, *supra* note 86, at 357.

[90] *Id.*

[91] *Id.*

[92] *See, e.g.*, PERMANENT SUBCOMM. ON INVESTIGATION, 107TH CONG., THE ROLE OF THE BOARD OF DIRECTORS IN ENRON'S COLLAPSE 3, 11 (Comm. Print 2002) (finding misconduct by Enron's fiduciaries detrimental to shareholders, employees, and business associates).

[93] *See supra* Part III.

B. Possible Debarment Standards

In order to face possible debarment under this article's proposal, an organization's governing fiduciaries, as noted above, must *at least* have breached the applicable state law duty of care, but an additional determination also must be made: is it appropriate, even given the care (or loyalty) breach, to bar this particular wrongdoer under these circumstances from future service at this organization or at a similar one? Presumably, by no means will all fiduciary duty breaches automatically or necessarily lead to debarment. That would be overbroad. Instead, an additional standard must be met, this one to be provided by bankruptcy law itself through an amendment to the Bankruptcy Code. Two possible approaches are sketched.

First, the Code might follow the very recent approach taken by Congress and the FDIC with respect to "clawbacks" of executive pay at failed financial institutions. Pursuant to congressional mandate,[94] the FDIC in July 2011 adopted a rule that, as receiver of a failed institution, it could file an action to recover from any current or former executive or director "substantially responsible for the failed condition of the covered financial company" any compensation received during the two-year period preceding appointment of the FDIC as receiver.[95] A person is deemed to be "substantially responsible" if he or she failed to conduct his or her responsibilities with the degree of skill and care an ordinarily prudent person in a like position would exercise under similar circumstances *and*, as a result, individually or collectively, caused a loss to the institution that materially contributed to the failure of the company.[96] Moreover, it is presumed, subject to rebuttal, that certain persons are "substantially responsible" for the failed condition: the chair of the board of directors, chief executive officer, president, chief financial officer, or any other person regardless of title if "he or she had responsibility for the strategic, policymaking, or company-wide operational decisions . . . ."[97]

An alternative approach would be to look to the debarment tests applicable under federal securities law.[98] Here, either the simple "unfitness" standard could be adopted,[99] with bankruptcy courts developing more detailed standards via case law, or the Code could adopt, with some modification, a leading test for considering

[94] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 210(s), 12 U.S.C. § 5390(s) (Supp. 2010) (the "Dodd-Frank Act").

[95] 12 C.F.R. § 380.7(a) (2011).

[96] *Id.* § 380.7(a)(1)-(2).

[97] 12 C.F.R. § 380.7(b)(1)(i) (construing executives or directors holding those or similar titles as presumptively responsible for failed condition of company provided they had decision making responsibilities). Other presumptions also are set forth in the FDIC rule. *See, e.g.*, 12 C.F.R. § 380.7(b)(1)(ii) (holding executive or director presumptively responsible for failed condition of company if found liable by court for breaching duty of loyalty to company).

[98] *See supra* Part III.

[99] *See supra* note 59.

debarment under the federal securities laws.[100] There are six pertinent factors in this test, including, as modified here from the securities law setting to fit the duty of care breach standard advocated above: (1) the egregiousness of the underlying violation; (2) the defendant's "repeat offender" status; (3) the defendant's role or position in the company; (4) the degree of scienter (here inapplicable as long as the fiduciary is at least grossly negligent); (5) the defendant's economic stake in the violation; (6) the likelihood the misconduct will recur.[101]

Courts have emphasized that these factors are not exclusive, and that it is not necessary to apply all factors to every case.[102] Rather, judges are to have "substantial discretion" in determining whether someone is "unfit" and, ultimately, untrustworthy, for future service.[103] One additional factor might be the duration of the neglect. And, empirical evidence as to recidivistic behavior by governing officials of bankrupt organizations would be pertinent in a particular proceeding and would, if showing a pattern of repeated governance failures by high officials, bolster the debarment proposal.

Other approaches are possible of course. The key point is that where there is a fiduciary duty breach leading to an organization's financial failure—for whatever reason, financial or sexual—certain high-level fiduciaries, post-bankruptcy, should be foreclosed from holding comparable fiduciary posts in the future. This bar may simply be to prevent them from serving in that particular organization or it might extend to all organizations in a particular industry. Currently, under section 1129(a)(5)(A) of the Bankruptcy Code, a court

> shall confirm a plan only if all of the following requirements are met . . .The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy . . . .[104]

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[100] *See, e.g.*, SEC v. Patel, 61 F.3d 137, 140–41 (2d. Cir. 1995) (adopting six-factor "substantial unfitness" test used to determine whether defendant should be barred from serving as officer or director of public company in future).

[101] *Id.* at 141. This test is drawn from an article by Professor Jayne Barnard. Jayne W. Barnard, *When is a Corporate Executive "Substantially Unfit to Serve"?*, 70 N.C. L. REV. 1489, 1492–93 (1992); *see also* Barnard, *supra* note 55 and accompanying text (noting power of SEC to bar brokers, investment advisors, and investment company managers from serving as officers or directors of public companies).

[102] *Patel*, 61 F.3d at 141

[103] *Id.* (stressing courts should have substantial discretion in deciding whether to bar employment in public companies); *see* Crimmins, *supra* note, 61 at 719–20 (indicating application of *Patel* factors often springs from judge's moral view that director "has been a central figure in a serious fraud and should not be trusted . . . with public trust ever again").

[104] 11 U. S. C. § 1129 (2006).

This suggests that, currently, it is important to the success of the future reorganization—and public policy—to have the right persons in office, and to foreclose the wrong persons from further service.[105] Moreover, only in rare and extraordinary circumstances should the bar be permanent. More typically, it would last from one year to five years and perhaps would be coupled with a requirement of intensive specialized training in fulfilling governance responsibilities and fiduciary duties. Such a period is long enough to hurt financially and to bring a useful degree of professional shame, while also permitting word of the debarment order to spread as a warning to others. The shame factor, of course, will work better in some organizational settings—one thinks here of religious organizations—than in others where professional skin is thicker or business mores are more hardnosed.[106] The debarment remedy, moreover, does not visit money damages *per se* on the wrongdoer, thereby blunting potential criticisms that it will dissuade persons from serving in senior governance positions or lead to excessive risk averse behavior for fear of personal monetary liability, and it does not penalize the company itself and thereby compete with private creditors for limited organizational funds. Critically, it is forward looking and preventive in its orientation.

C. *Objections; the Debarment Proponent*

The most basic objection to this article's proposal likely is that federal bankruptcy law has an important but relatively narrow aim. In a liquidation, the objective is to identify and gather all available assets (including monetizable claims against fiduciaries for wrongdoing) and make an orderly distribution to a firm's claimants according to a priority system.[107] In a firm's reorganization, the purpose is to reorganize claims against the debtor in a way that allows the company to move forward to become productive once again.[108] Any sanctioning of wrongdoers that

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[105] *In re* Spectrum Arena, Inc., 340 F. Supp. 794, 802 (E.D. Pa. 1971) (disclosure of debtor's manager designed to insure able and trustworthy management who could successfully operate reorganized corporation), *aff'd,* 46 2 F.2d 156 (3d Cir. 1972).

[106] The Disney directors and officers were severely scolded and rebuked by Chancellor Chandler in the *Disney* litigation. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 762–63 (Del. Ch. 2005), *aff'd,* 906 A.2d 27 (Del. 2006) ("Eisner's actions in connection with Ovitz's hiring should not serve as a model for fellow executives and fiduciaries to follow. His lapses were many . . . . To my mind, these actions fall far short of what shareholders expect and demand from those entrusted with a fiduciary position."). The Chancellor bluntly and publicly chastised them in an effort to warn others occupying fiduciary positions. *See* Lyman Johnson, *Counter-Narrative in Corporate Law: Saints and Sinners, Apostles and Epistles*, 2009 MICH. ST. L. REV. 847, 860–64 (discussing Chancellor Chandler's derisive, biting opinion scolding directors and officers in *Disney*). Whether such judicial rebuking made a difference at Disney or at other companies is impossible to know.

[107] Alces, *supra* note 54, at 635.

[108] *Id.* at 636; *see* Lipson, *supra* note 73, at 378–79 (highlighting bankruptcy law's competing goals of "preserving going concerns and maximizing property available to satisfy creditors").

does not augment the debtor's estate, the argument runs, simply falls outside the domain of bankruptcy.[109]

By viewing bankruptcy as a "standalone" single-company legal regime, the objection has force. But should the occasion of bankruptcy—particularly of large, systemically significant debtors affecting vast numbers of people or of a religious entity affecting fewer people but possibly doing so more deeply—be thought of only in this way?[110] And even as to smaller debtors, if rehabilitation is the aim, part of that surely involves ensuring that the debtor's top officials don't retrace the journey into financial distress.[111] Moreover, although bankruptcy law currently has a "single firm" focus, perhaps the resolution of a particular reorganization proceeding should give some heed to whether those who caused dire financial trouble ought to be free to go elsewhere and repeat their mistakes. In treating physical illness or disease, for example, we don't simply seek to restore the afflicted person to good health, we seek to stop the spread of whatever contagion is causing the problem so as to protect others. Likewise with financial distress, why not halt a possible reoccurrence by quarantining those who caused it? This is precisely what debarment orders do under existing non-bankruptcy laws.

Ultimately, resolution of this issue depends on whether bankruptcy should be viewed in a broader, more economically and financially integrated manner that takes account of post-bankruptcy effects on other firms where those possible effects are directly related to a factor substantially contributing to the initial bankruptcy—faithlessness by fiduciaries. So viewed, in at least some cases—perhaps a small set—the repercussions of letting those responsible for financial failure blithely move on to other firms should be considered by a bankruptcy court. In doing so, and in applying the standards described in Subpart B[112] above, the court would place special emphasis on the degree of culpability and its duration, consequences, and likelihood of recurrence.

Even if bankruptcy is a proper venue for a more holistic assessment of fiduciary responsibility for financial failure, the question arises as to who would raise and pursue the matter. In the typical chapter 11 proceeding, the organization's

[109] *But see supra* text accompanying notes 104–105.

[110] In the early 1990s, Donald Korobkin argued, broadly, that bankruptcy "provides a forum in which competing and various interests and values accompanying financial distress may be expressed and sometimes recognized." Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 721 (1991). Consequently, in this normative vision of bankruptcy, "it is a medium by which the enterprise's moral, political, social and economic aims are defined and redefined." *Id.* at 772. This article is not picking up on Korobkin's vision of bankruptcy as such in advancing the debarment concept. But Korobkin does provocatively open the question as to what the aim(s) of bankruptcy should be.

[111] To be sure, evidence suggests that many management teams are changed shortly before or after bankruptcy. Dickerson, *supra* note 28, at 915 (reporting empirical studies show officers are replaced in roughly half of firms about to file, or which have filed, for bankruptcy). It is less clear, however, that non-employee directors or trustees or other governing officials also change. *See also supra* text accompanying notes 104-105.

[112] *See supra* Part IV.B.

fiduciaries continue to run the business as the debtor-in-possession ("DIP").[113] These persons may include some of the faithless fiduciaries themselves and they obviously would not be motivated to act against their self-interest. And even as to wrongdoing by former fiduciaries, it is unlikely that current fiduciaries see much economic gain to themselves or the debtor in seeking debarment relief.

On conversion of a case to chapter 7, the state law fiduciaries are ousted and a trustee takes over.[114] Moreover, a judge can strip fiduciaries of control, and appoint a trustee, even in a chapter 11 case.[115] Where there is wrongdoing by current management, many commentators believe a trustee should be appointed.[116] Besides the need for courts to regard directors and trustees as falling within the statutory term "management," and thereby appointing a trustee where they, as well as officers, are misbehaving (as by neglect), the problem of incentives for a trustee to seek debarment relief still remains. A chapter 11 and chapter 7 trustee may be primarily interested in assembling and distributing assets.

Similar incentive problems arise with committees of creditors and investors, and with the SEC. Committee duties are listed in Bankruptcy Code section 1103,[117] and include consulting with the DIP, investigating the DIP's pre-petition and post-petition conduct, and participating in the reorganization plan process.[118] Creditors and investors likely also are focused on maximizing their share of the debtor's estate,[119] not seeking debarment relief with prospective reach only. Likewise, the SEC has jurisdiction only over securities law violations, not state law fiduciary duty breaches. If the SEC believes those involved in the bankruptcy of a public company should be debarred, it can seek that relief in its own separate proceedings,[120] but in doing so it is limited to a federal securities law violation involving scienter as a predicate offense.[121]

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[113] 11 U.S.C. § 1107(a) (2006) (explicating rights, powers, and duties of DIPs under chapter 11). *See generally* John Butler, Jr., et al., *Preserving State Corporate Governance Law In Chapter 11: Maximizing Value Through Traditional Fiduciaries*, 18 AM. BANKR. INST. L. REV. 337, 341–42 (2010) (observing § 1107 gives DIP broad rights, powers, functions and duties of a chapter 11 trustee).

[114] 11 U.S.C. §§ 701–704 (enumerating procedures for establishment, election, and line of succession of chapter 11 trustee, as well as duties trustee must undertake). A bankruptcy court may lack power to convert a religious organization proceeding to chapter 7. *Id.* at § 1112(c) (providing that a court may not convert a case under chapter 11 to a case under chapter 7 if debtor is not a moneyed business or commercial corporation); Lipson, *supra* note 73, at 401 & n.206 (remarking bankruptcy courts cannot use chapter 7 to liquidate a diocese without diocese's consent).

[115] 11 U.S.C. § 1104(a)(1)–(2) (providing for appointment of trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management"); *see also* Alces, *supra* note 54, at 642 & n.47 (stating that Bankruptcy Code requires U.S. Trustee to move for appointment of chapter 11 trustee under specified circumstances). This, however, apparently is rare. Alces, *supra* note 54, at 644 & n.57 (observing appointment of chapter 11 trustees is seen as "last resort").

[116] Butler, *supra* note 113, at 351 n.61.

[117] 11 U.S.C. § 1103 (outlining powers and duties of committees).

[118] Harner, *supra* note 27, at 486 (specifying certain duties of committees under section 1103).

[119] Dennis Klein & Mira Vayda Edelman, *Litigating Against Directors and Officers of Bankrupt Dot-Com Entities: A Potential Asset for the Debtor's Estate*, 27 DEL. J. CORP. L. 803, 803–04 (2002) (noting creditors' committees maximize recovery for estate).

[120] *See supra* note 60 and accompanying text.

[121] *See supra* Part III.

The best candidate for pursuing debarment relief, under any new congressional grant of authority, would be an examiner. Currently, appointment of an examiner is said to be rare,[122] but some believe it is still overdone.[123] Section 1104(c) sets forth two grounds for the appointment of an examiner,[124] each on request of the U. S. Trustee or a party in interest.[125] One such ground is where the "debtor's fixed, liquidated, unsecured debts, other than for goods, services, or taxes, or owing to an insider, exceed $5,000,000."[126] Thus, under current law appointing an examiner is not possible in many bankruptcy cases due to the size of debt requirement, but would be available in all of the more financially significant cases.

An examiner, presumably, is a neutral party able to conduct an independent review.[127] Moreover, section 1104(c)'s language evinces Congress' intention for an examiner to play an investigatory role.[128] The examiner's role is

> to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor . . . .[129]

Two points are striking. First, an examiner may investigate the conduct of former as well as current management.[130] Second, the investigation is not limited to illegal or fraudulent conduct but extends to "incompetence" and "mismanagement."[131] These terms sweep far more broadly than disloyal or careless behavior of the sort proscribed by, and actionable under, state fiduciary duties,[132] and would seem to encompass the sorts of substantively poor strategic, monitoring, and risk management decisions recently exhibited by many leaders of bankrupt organizations, both business and religious.[133] The question naturally arises as to why an examiner is authorized to investigate for incompetence and mismanagement

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[122] Alces, *supra* note 54, at 635 n.15.

[123] *See* Butler, *supra* note 113, at 350 n.58 (citing authorities arguing that appointment of examiner will delay proceedings).

[124] 11 U.S.C. § 1104(c) (2006).

[125] Butler, *supra* note 113, at 349. The U. S. Trustee is authorized to "raise and may appear and be heard on any issue in any case or proceeding . . . ." 11 U.S.C. § 307. The U.S. Trustee has supervisory duties over the DIP. 28 U.S.C. § 586(a)(3) (2006). Given the lack of clear incentives for other parties to seek debarment—or even appointment of an examiner—in order for debarment relief to be viable, the U.S. Trustee will have to more assertively seek an examiner where wrongdoing is suspected.

[126] 11 U.S.C. § 1104(c)(2).

[127] *In re* Big Rivers Elec. Corp., 284 B.R. 580, 596 (Bankr. W.D. Ky. 2002) (noting Code requires an examiner to be "neutral" and "disinterested").

[128] Butler, *supra* note 113, at 350.

[129] 11 U.S.C. § 1104(c).

[130] *Id.*

[131] *Id.*

[132] *See supra* notes 30–40 and accompanying text.

[133] *See supra* notes 73–76, 81–91 and accompanying text.

if nothing, sanction-wise, can come of it. Conversely, if incompetence and mismanagement are pertinent under current bankruptcy practice, once unearthed, why not, in certain circumstances,[134] also make that finding a basis for deterring such conduct in the future via a debarment order? A determination of incompetence/mismanagement thus would be germane to the particular bankruptcy proceeding while also supporting efforts to halt its transmission to other organizations.

D. Governance of Religious Organizations and the First Amendment

Religious organizations can file for bankruptcy,[135] but as David Skeel has aptly observed, "church bankruptcy is uncharted waters for a bankruptcy process that is designed with ordinary business in mind."[136] In the bankruptcy of a religious organization, there can be a clash of interests between innocent creditors—whether victims of sexual abuse or financial improprieties—and equally innocent parishioners who face the prospect of church property being liquidated to pay debts and, therefore, unavailable for worship, mission, and related activities.[137] This clash, in turn, reflects potential conflict between state law property and organizational governance rules, typically applicable in bankruptcy,[138] and internal governance provisions (canon law) of the churches themselves, such provisions being entitled, with somewhat murky boundaries, to constitutional protection under the First Amendment.[139]

An instructive example arises from the bankruptcy of certain Catholic dioceses in conjunction with the well-known priest sex abuse cases. Under canon law, each parish (even if unincorporated under state law) is considered a separate juridic entity and, as such, its property, while available to satisfy parish creditors, would not typically be available to satisfy claims of creditors of other parishes within the diocese or of the diocese itself, each of which also is a distinct juridic entity.[140] Under secular state law, however, failure to incorporate a church parish might mean it is not legally distinct, and that its assets are part of the diocesan estate and fully available to diocesan creditors.[141] Professor Lipson has described how courts have struggled with this issue.[142] More "congregational" church governance structures,

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[134] *See supra* Part IV.B.

[135] Lipson, *supra* note 73, at 384.

[136] David A. Skeel, Jr., *"Sovereignty" Issues and the Church Bankruptcy Cases*, 29 SETON HALL LEGIS. J. 345, 346 (2005).

[137] Lipson, *supra* note 73, at 365.

[138] *See* Butner v. United States, 440 U.S. 48, 54–55 (1978) (holding that, in absence of Congressional legislation, state law controls determination of property rights in assets of bankrupt estate).

[139] Lipson, *supra* note 73, at 365–70 (discussing protections of Establishment and Free Exercise Clauses).

[140] The author thanks Professor Charles Reid, an expert on canon law at the University of St. Thomas (Minneapolis) School of Law, for his guidance on these points.

[141] Lipson, *supra* note 73, at 373–74. Likely, after the abuse scandals, parishes and dioceses are being separately incorporated in an effort to partition the assets of each from the liabilities of other parishes.

[142] *Id.* at 371–77 & n.34 (discussing bankruptcy cases involving diocese liability for priest misconduct).

where local bodies are more likely to be legally distinct entities, may not face this risk.

These property disputes reveal an underlying jurisprudential (and jurisdictional) issue: who makes the governance rules for a religious organization, the organization itself under canon law, or secular lawmakers, as with business and other nonprofit organizations? Due to the First Amendment's Free Exercise and Establishment Clauses,[143] the former may be constitutionally required,[144] although the scope of that protection with respect to certain organizational governance matters is far from clear. If so, then a proposal to amend the Bankruptcy Code to permit a court to enter a bar order would be unconstitutional, unless it includes an exemption for religious organizations. This would mean, at a more general level, that secular law could, with respect to business organizations and secular nonprofit organizations, but could not, with respect to religious organizations, play a more active role in preventing governance lapses.

Currently, the contours of judicial deference to canon law largely have been developed in conjunction with property disputes of the kind noted above and in employment discrimination cases under Title VII.[145] Few cases directly address the interplay of canon law and secular law with respect to non-clergy members of an organization's governing body, be it, for example, a Catholic parish council or diocese, a Presbyterian board of elders or presbytery, or a Southern Baptist board of trustees, although, as noted below, dicta in key cases is quite broad. Nor is it clear whether governance matters within all "religious organizations" such as primary and secondary schools, universities, hospitals, and other charities will be treated the same as governance within churches themselves.

In several decisions addressing property disputes in religious organizations,[146] the United States Supreme Court articulated the church autonomy doctrine, eventually according it constitutional protection.[147] Of especial importance is *Kedroff v. St. Nicholas Cathedral of the Russian Orthodox Church in North*

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[143] The First Amendment provides, in part, that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." U.S. CONST. amend. I. The American Law Institute currently is sponsoring a project on the Principles of the Law of NonProfit Organizations. Tentative Draft No. 3, dated April 18, 2011, has noted, in several sections, that for "constitutional and other prudential reasons . . . attorneys general and courts have curtailed jurisdiction over churches . . . ." A.L.I., PRINCIPLES OF THE LAW OF NONPROFIT ORGS., Tentative Draft No. 3, Apr. 18, 2011, Introductory Note, cmt. d, at p. 51.

[144] *See* Lipson, *supra* note 73, at 365–70 (suggesting First Amendment may offer statutory protections to religious organizations in bankruptcy).

[145] Title VII Civil Rights Act of 1964 §§ 701–18, 42 U.S.C. §§ 2000e–e-17 (2006); *see* Thomas C. Berg, *Religious Organizational Freedom and Conditions on Government Benefits*, 7 GEO. J.L. & PUB. POL'Y, 165, 215 (2009) (noting "absolute nature" of internal affairs protection).

[146] *See, e.g.*, Jones v. Wolf, 443 U.S. 595 (1979); Serbian E. Orthodox Diocese for the U.S. & Can. v. Milivojevich, 426 U.S. 696 (1976); Kedroff v. Saint Nicholas Cathedral of the Russ. Orthodox in N. Am., 344 U.S. 94 (1952); Gonzalez v. Roman Cath. Archbishop of Manila, 280 U.S. 1 (1929); Watson v. Jones, 80 U.S. 679 (1871).

[147] *See Kedroff*, 344 U. S. at 116 (holding religious organizations have "power to decide for themselves, free from state interference, matters of church government as well as those of faith and doctrine. Freedom to select the clergy . . . must now be said to have federal constitutional protection as a part of the free exercise of religion against state interference").

America.[148] There, the Court invalidated a New York statute purporting to transfer control over Russian Orthodox churches in the United States from the Moscow patriarch to authorities selected by the North American diocese.[149] Although involving a dispute over property, power over the internal governance and decisionmaking structure of a church was the real issue, the Court stating that "[l]egislation that regulates church administration, the operation of the churches, [or] the appointment of clergy . . . . prohibits the free exercise of religion."[150] And, the First Amendment requires that religious organizations have the "power to decide for themselves, free from state interference, matters of church government as well as those of faith and doctrine."[151]

Kedroff was expanded on in a 1976 case holding that a civil court had no authority to hear a suit seeking to force a church to reinstate a defrocked bishop—a remedy that, essentially, is the opposite of a debarment order.[152] The Court stated that "questions of church discipline and the composition of the church hierarchy are at the core of the ecclesiastical concern,"[153] and are "not the proper subject of civil court inquiry."[154] Religious organizations, in short, are constitutionally protected in establishing "their own rules and regulations for internal discipline and government."[155] Importantly, the Court cautioned against the dangers of judicial inquiry itself, such as "evaluat[ing] conflicting testimony concerning internal church procedures,"[156] lest the result be judicial "intrusion into a religious thicket."[157]

The scope of church autonomy over internal affairs, and so church immunity from legislative and judicial intervention, has received conflicting treatment by

[148] 344 U.S. 94 (1952). For a full telling of the *Kedroff* "story," *see* Richard W. Garnett, "*Things That Are Not Caesar's: The Story of Kedroff v. St. Nicholas Cathedral,*" in FIRST AMENDMENT STORIES (Richard W. Garnett & Andrew Koppelman, eds. 2011).

[149] *Kedroff*, 344 U.S. at 108.

[150] *Id.* at 107–08.

[151] *Id.* at 116.

[152] *See* Serbian E. Orthodox Diocese for the U.S. & Can. v. Milivojevich, 426 U.S. 696, 709 (1976) (holding First and Fourteenth Amendment preclude courts from inquiring into religious decisions made by ecclesiastical tribunals).

[153] *Id.* at 717; *see also* Gonzalez v. Roman Cath. Archbishop of Manila, 280 U.S. 1, 16 (1929) (noting "it is the function of the church authorities to determine what the essential qualifications of a chaplain are and whether a candidate possesses them").

[154] *Milivojevich*, 426 U.S. at 713.

[155] *Id.* at 724 (explaining extent of First and Fourteenth Amendment protection for religious organizations). On "church autonomy," *see* Douglas Laycock, *Towards a General Theory of the Religion Clauses: The Case of Church Labor Relations and the Right to Church Autonomy*, 81 COLUM. L. REV. 1373, 1373 (1981) ("[C]hurches have constitutionally protected interest in managing their own institutions free from government interference.").

[156] *Milivojevich*, 426 U.S. at 718.

[157] *Id.* at 719. This "entanglement" theme was reiterated in *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 502 (1979) ("It is not only the conclusions that may be reached by the [National Labor Relations] Board which may impinge on rights guaranteed by the Religion Clauses, but also the very process of inquiry leading to findings and conclusions.").

federal appeals courts in Title VII employment discrimination cases[158]—where, doctrinally, it is called the "ministerial exception"[159]—and that issue is now before the United States Supreme Court for the first time.[160] Courts have differed over whether the focus should only be on which non-clergy employees of a religious organization are considered "ministers" such that they are not protected by the nondiscrimination provisions of Title VII.[161] Although that is the approach taken by many courts—while focusing on a person's functional role within the organization, not mere ordination[162]—other courts examine more narrowly the nature of the dispute, not merely the nature of the employee.[163]

Under the broader approach taken by the majority of circuits, the focus is on whether an employee's "primary duties consist of teaching, spreading the faith, church governance, supervision of a religious order, or supervision or participation in religious ritual and worship."[164] Even this "primary duties" test, however, necessarily involves judicial assessment of whether an employee's duties are religious or secular.[165] To avoid even that degree of judicial intrusion may require adoption of the Seventh Circuit's presumption that an employee is "ministerial" unless he or she functions entirely in a commercial manner.[166] Professors Ira Lupu and Robert Tuttle, however, argue that permitting judicial determination of which positions are "ministerial" is no different than judicially applying definitions of "religion" and "minister" of the sort found throughout the law.[167]

The Supreme Court has never addressed this issue. During the October 2011 term, it likely will give important guidance on the boundaries of the ministerial

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[158] *See* Todd Cole, *The Ministerial Exception: Resolving The Conflict Between Title VII And The First Amendment*, 4 CHARLESTON L. REV. 703, 729–36 (2010) (describing different judicial approaches).

[159] *Id.* at 704 (stating courts have created ministerial exception). Professor Christopher Lund recently has sought to ground the ministerial exception doctrine on three components—relational, conscience, and autonomy. Christopher Lund, *In Defense of the Ministerial Exception*, 90 N.C. L. REV. (forthcoming 2011). Judge Richard Posner believes the "minister's exception" is better termed the "internal affairs" doctrine in recognition of its grounding on avoiding judicial involvement in internal religious matters and in light of the fact that it encompasses persons who are not ordained ministers. Schleicher v. Salvation Army, 518 F.3d 472, 475 (7th Cir. 2008); Tomic v. Cath. Diocese of Peoria, 442 F.3d 1036, 1039 (7th Cir. 2006).

[160] *See EEOC v. Hosanna-Tabor Evangelical Lutheran Church & School*, 597 F.3d 769, 769 (6th Cir. 2010), *cert. granted*, 131 S. Ct. 1783 (2011).

[161] Cole, *supra* note 158, at 707–08 (discussing history of ministerial exception).

[162] *Id.* at 707(describing "primary duties" test).

[163] *Id.* at 708. Many scholarly commentators are quite critical of the exception and would abolish it or narrow it. Lund, *supra* 159, at 5 n.6 (listing authors who have proposed abolishing or substantially narrowing ministerial exception).

[164] Rayburn v. Gen. Conference of Seventh-day Adventists, 772 F.2d 1164, 1169 (4th Cir. 1985) (detailing broad approach to ministerial exception).

[165] EEOC v. Sw. Baptist Seminary, 651 F.2d 277, 283 (5th Cir. 1981) (holding employees' status as ministers is"a legal conclusion subject to plenary review").

[166] *See, e.g.*, Schleicher v. Salvation Army, 518 F.3d 472, 477–78 (7th Cir. 2008) (proposing adoption of ministerial presumption).

[167] Ira C. Lupu & Robert W. Tuttle, *Courts, Clergy, and Congregations: Disputes Between Religious Institutions and Their Leaders*, 7 GEO. J.L. & PUB. POL'Y 119, 148 (2009). Professors Lupu and Tuttle argue that a church congregation's labeling of a position as a "minister" is relevant but should not preclude an independent judgment about the nature of the position. *Id.*

exception in the Title VII context but also perhaps on church autonomy in internal governance affairs more generally.[168] Title VII cases, however, involve employees only, not other governing officials within a religious organization. Currently, we have little direction on how non-employee, non-clergy members of an organization's governing body—whether hierarchical or congregational—would be treated if they behaved recklessly in performing their duties, particularly where secular law and canon law might be at odds. Can a court, bankruptcy or otherwise, determine what fiduciary duties are owed by those who govern religious institutions, and whether those duties have been breached, without "intruding" into a religious thicket? This issue extends to lay members of parish councils, members of boards of elders or trustees or presbyteries, or other church governing bodies, and includes persons those who govern organizations with a religious mission (schools, for example) that are not churches.

Misperformance by these persons may lead the organization itself to harm third parties, but such higher-level governing officials themselves do not interact with third parties—as do clergy members or other employees—and therefore they are not agents of the entity and the entity likely would have no personal liability to a third party.[169] Nor is the entity itself directly liable to third parties due to such faulty oversight, as it is for employee or clergy wrongdoing.[170] As a result, third parties may be harmed by faulty governance, but third parties have no voice in internal affairs and cannot vote against or otherwise seek to sanction governing officials. Thus, one rationale for debarment relief in the religious entity setting would be to prevent harm to third parties who are not part of the religious governance structure itself. Breakdowns in governance frequently radiate outside an organization rather than tidily remain within. Governance deficiencies, therefore, while an "internal" matter for ecclesiastical law in one respect, can nonetheless visit irremediable costs "externally" of a sort secular law might properly seek to address.[171]

Certainly, several Supreme Court decisions, including *Kedroff* and others,[172] have used broad language in describing the scope of church autonomy over internal governance in relation to secular judicial intrusion,[173] but they do not address supervisory governance specifically. The Supreme Court did affirm the

[168] *See supra* note 160 and accompanying text. For a good discussion of the facts and the Sixth Circuit's opinion, *see* Lund, *supra* note 159, at Part VII.

[169] Arnold v. Society for Savings Bancorp., Inc., 678 A.2d 533, 539-40 (Del. 1996) (directors of corporation are not agents); Doe v. Corp. of President of Church of Jesus Christ of Latter Day Saints, 98 P.3d 429, 433 (Utah Ct. App. 2004) (holding church not liable for acts of "High Priest and scout leader" who was neither an employee, agent, or clergy member).

[170] *See, e.g.*, Meyer v. Lindala, 675 N.W.2d 635, 639 (Minn. Ct. App. 2004) (determining Congregation had no duty to protect victims from sexual molestation of congregation member because "affirmative duty to act only arises when a special relationship exists between the parties").

[171] Schmidt v. Bishop, 779 F. Supp. 321, 332 (S.D.N.Y. 1991) (noting Church's "intricate principles of governance, as to which the state has no rights of visitation").

[172] *See supra* notes 146–157 and accompanying text.

[173] Kedroff v. Saint Nicholas Cathedral of the Russ. Orthodox in N. Am., 344 U.S. 94, 116 (1952) (declaring Church's "independence from secular control or manipulation").

appointment of a receiver to liquidate the property of the Mormon Church in the late nineteenth century,[174] as lower courts have done subsequently with respect to other religious entities.[175] These cases, moreover, went beyond bar orders merely prohibiting someone from serving in a governance capacity while leaving the organization intact, and involved the affirmative appointment of someone from outside the church to oversee a liquidation proceeding.[176] Winding up an organization in an effort to end its existence is different, however, than governing an operating entity. Even in the final termination stage, in 2008, the Model Nonprofit Corporation Act was revised to provide that, in a dissolution proceeding for a religious corporation, no receiver or custodian may be appointed.[177]

Two state court decisions upheld the removal of directors/trustees of religious organizations. The first, a 2000 North Dakota Supreme Court decision,[178] upheld the five-year removal of a director of Help and Caring Ministries, Inc., a nonprofit corporation which, with affiliated entities, was engaged in a variety of Christian ministry activities.[179] The lower court found that the director-founder had engaged in significant mismanagement and improper self-dealing.[180] In an action begun by the North Dakota Attorney General to involuntarily dissolve the entities, the Supreme Court upheld the director's removal, citing a Wisconsin case rejecting a First Amendment free exercise argument by a removed director,[181] even though in the case before it the director himself had not made a free exercise argument.[182] The Court did not consider the Establishment Clause with respect to the removal issue,[183] even though elsewhere in the opinion it had extensively addressed that issue in overturning the trial court order outlining a procedure for reconstituting the board.[184] The North Dakota Supreme Court was troubled by judicial intervention

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[174] Late Corp. of the Church of Jesus Christ of Latter-Day Saints v. United States, 136 U.S. 1, 66 (1890).

[175] Lipson, *supra* note 73, at 402 & n.216.

[176] *In re* United Church of the Ministers of God, 74 B.R. 271, 279 (Bankr. E.D. Pa. 1987) (appointing trustee from court's panel of Trustee's).

[177] MODEL NONPROFIT, *supra* note 5, at § 14.32(f) (2008). The Model Act does permit dissolution of a religious corporation, however, even upon the petition of a judgment creditor, *id.* at § 14.30, but apparently leaves the dissolution activities in the hands of the organization's governing body, not a receiver or custodian. The Model Act serves as a model for numerous state statutes. It contains several special provisions for religious organizations. *See supra* note 68 and accompanying text.

[178] State of North Dakota *ex rel.* Heitkamp v. Family Life Services, Inc., 616 N.W.2d 826, 829 (N.D. 2000) (affirming district court's decision to remove director from board for five years).

[179] *Id.* at 829.

[180] *See generally* State of North Dakota *ex rel.* Heitkamp v. Family Services, Inc., No. 96-88, 1999 WL 34758432 (D.N.D. Jan. 25, 1999), *aff'd in part, rev'd in part,* 616 N.W.2d 826, 829 (N.D. 2000) (finding director-founder comingled trust funds and used corporate property for personal use, among other things).

[181] John v. John, 450 N.W.2d 795, 801 (Wis. Ct. App. 1989), *cert. denied,* 498 U.S. 814 (1990).(rejecting directors free exercise argument on grounds that court ordered injunction did not impose burden on director's ability to exercise Roman Catholicism).

[182] *Family Life Services, Inc.*, 616 N.W.2d at 843 (noting director had not made any free exercise argument).

[183] *Id.* at 842–43 (discussing the removal issue purely on due process grounds).

[184] *Id.* at 837–42 (relying on Establishment Clause analysis for reconstitution issue).

into affirmatively constituting the governing body, but not by judicial barring of a wrongdoer from that body.[185]

The second case, from the Wisconsin Court of Appeals,[186] upheld a judgment permanently enjoining a founder of a nonprofit corporation formed for religious, charitable, and educational purposes from serving as a director or trustee.[187] The removed director had breached his fiduciary duties and engaged in mismanagement.[188] The appeals court rejected the director's First Amendment free exercise argument because removal did not interfere with his ability to practice Roman Catholicism.[189] The court did not have before it, nor did it address, however, an Establishment Clause argument. Consequently, the issue of "entanglement" in a church's internal affairs under the church autonomy doctrine was not considered.

It might be argued, on the one hand, that by ordering removal, which separates (rather than elects or reinstates) a director/trustee from governing the organization, a court is not thereafter "entangled" in the entity's internal affairs. Moreover, removal of a director under a state corporation law provision presumably would be predicated on the same neutral, nonreligious grounds for religious organizations as for business organizations.[190] On the other hand, a court must hear evidence of internal wrongdoing to determine, in the first place, that removal is appropriate.[191] This would clearly seem improper with respect to a clergy member in a church.[192] Whether the same reasoning would extend to high-level lay members of governing bodies of churches—or of other non-church but religiously-oriented entities—depends on the contours of the church autonomy doctrine. These contours, currently, are unclear.

The Supreme Court may bring greater clarity on this issue in the *Hosanna-Tabor* case,[193] albeit that is a Title VII case involving an employee of a religious corporation, not a non-employee director or trustee or other governing official.[194] Permissible secular law inroads into the supervisory governance of religious organizations will remain murky until more attention is given to the ways in which governance failures in that setting can adversely affect third parties "outside" the

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[185] *Id.* at 841.

[186] *See John*, 450 N.W.2d 795.

[187] *Id.* at 806 (affirming judgment enjoining founder of corporation which provided financial support for religious, charitable, and educational causes).

[188] *Id.* at 798 (finding trial court was correct in concluding director's conduct was "gross misconduct").

[189] *Id.* at 801 (stating judgment only brought to conclusion director's relationship with corporation, not his right to freely exercise his religion).

[190] *See supra* notes 65–67 and accompanying text.

[191] *See, e.g., John*, 450 N.W.2d at 799 (stating Wisconsin statute requires "proof or conviction of gross misconduct").

[192] *See, e.g.*, Maffei v. Roman Cath. Archbishop of Bos., 867 N.E.2d 300, 306 (Mass. 2007) (dismissing action predicated on breach of fiduciary or confidential relationship between member of Roman Catholic clergy and his lay congregants as raising matters of internal church governance that First Amendment forbids secular court from considering).

[193] EEOC v. Hosanna-Tabor Evangelical Lutheran Church & School, 597 F.3d 769, 769 (6th Cir. 2010), *cert. granted*, 131 S. Ct. 1783 (2011).

[194] *Id.* at 771 (involving teacher's claim against religious school from which she was terminated).

organization,[195] whether victims of sex abuse or any others harmed as a result of faulty organizational governance. Preservation of ecclesiastical autonomy over internal governance is perhaps constitutionally protected only when truly "internal" affairs are at stake, not when the imposition of costs on parties "external" to that governance system also must be considered.[196] Church and state may not so easily be separated when the claimed sphere of sovereignty of the one collides with the sovereign sphere of the other.

CONCLUSION

Today, high-level fiduciaries face little risk of meaningful legal sanctions for faithless behavior, even when misgovernance leads to organizational bankruptcy. This is true in business corporations as well as in nonprofit organizations, including churches and other religious institutions. Debarring certain persons from future service, as part of administering an organization's bankruptcy proceedings, can prevent further institution-jeopardizing misperformance while also sending a strong deterrence message to others.

Doing so requires that bankruptcy law not focus, as now, solely on a single bankrupt institution's welfare. Instead, future consequences in other institutional settings should be considered in an effort to avoid repeat, bankruptcy-inducing behavior. Also, governance considerations, not just financial factors, should play a more prominent role in certain bankruptcy proceedings where significant governance breakdown led to financial failure.

Debarment relief in the religious organizational setting raises jurisdictional questions that remain murky because the appropriate intersection of organizational governance considerations and First Amendment concerns is undeveloped. Governance failures here, as elsewhere, however, are not purely "internal" private-ordering ecclesiastical matters as to which secular courts must necessarily yield. Rather, misgovernance can radiate outward from religious as well as business organizations, causing severe damage to third parties who may be unable to hold legally accountable those faithless governing officials who permitted the organization to inflict harm.

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[195] A court may decide not to apply intra-church rules to disputes with third parties. *See In re* Cath. Bishops of Spokane, 329 B.R. 304, 324–25 (Bankr. E.D. Wash. 2005) (refusing to apply intra-church rules to third party asserting claim against bankruptcy estate). Less clear is what law governs where there is no "dispute" with a third party but a failure of organizational governance is thought to adversely affect third parties because of organizational bankruptcy.

[196] For example, a federal judge prohibited a lay person from working for any church or church-related business for twenty-seven months after she violated the terms of her release from prison on tax evasion charges. She had previously worked as a church secretary and for the National Baptist Convention. Graham Brink, *Edwards guilty of violating her probation*, ST. PETERSBURG TIMES, Sept. 28, 2002, *available at* http://www.sptimes.com/2002/09/28/TampaBay/Edwards_guilty_of_vio.shtml. Recently, a Ramsey County District Court Judge in Minnesota amended a "no-contact" order to bar a former church leader from having contact with anyone younger than age 18. Emily Gurnon, *Ex-Church leader admits molesting teen*, ST. PAUL PIONEER PRESS, Oct. 15, 2011, at A7.