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Who Owns the Local Church?
A Pressing Issue for Dioceses in Bankruptcy
By
Catharine Pierce Wells¹

Introduction

Slowly one could hear – in whispers at first, then in calm declarative statements – that the Catholic Church was considering bankruptcy. It would not be the entire church, of course. Instead, it would only be a handful of individual dioceses whose finances had been severely strained by damage claims arising from the sexual abuse scandal.² Such bankruptcies would break new ground. Churches had gone bankrupt before, but a diocesan bankruptcy would be different. A diocese is part of the Catholic Church and the Church itself is the largest, the oldest, and possibly the wealthiest religious organization in the world. With its size and its complex structure, it is an international world unto itself that few people understand. Certainly, the application of bankruptcy law to such an institution would involve a certain amount of confusion and controversy.

In this paper, I will explore two possible sources of confusion. The first is the non-commercial, charitable nature of the Church.³ The second is its organizational

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² Indeed, in July of 2004, the Archdiocese of Portland became the first Roman Catholic Archdiocese to file for bankruptcy. *See In re Roman Catholic Archbishop*, Bankr. L. Rep. (CCH) P80,225 (Bankr. D. Or. 2005). The Dioceses of Spokane and Tucson soon followed suit. Arthur H. Rotstein, *Tucson Diocese Files for Bankruptcy*, Washington Post, Sept. 21, 2004, at A22; *Diocese of Spokane Files for Bankruptcy*, Chicago Tribune, Dec. 7, 2004, at 19.

³ Religious organizations are considered to be charitable in nature. *See, e.g.*, I.R.C. § 501(c)(3). Both the state and federal government regulate them less strictly than other charitable organizations in deference to first amendment concerns. *See* Marion R. Fremont-Smith, *Governing Nonprofit Organizations: Federal and State Law and Regulation* (Harvard Univ. Press, 2004) [hereinafter Fremont-Smith].

complexity. The point of the discussion will not be to generate answers to particular legal controversies. As I will show, each controversy depends not only on its own peculiar facts, but also upon a melding of various different sources of law including bankruptcy law, trust law, and Canon Law. What I hope to bring to the discussion is the kind of larger perspective that comes from many years spent dealing with the practical problems of charitable organizations. As the Director of the Division of Public Charities for the Commonwealth of Massachusetts,⁴ I saw many charitable organizations in financial and legal distress. This experience led me to appreciate the complexity that surrounds these issues. There is not a single law of charities. Charities are governed by numerous state and federal statutes, regulations and common law doctrines. Further, when a subdivision of the Catholic Church declares bankruptcy, bankruptcy law and canon law are added to the mix. Individually, each of these laws is relatively straightforward; however, when they overlap, the result can be confusing. In this paper, I will focus on the overlap. Specifically, the paper will be divided into three sections. In the first section, I will explain why the equities and policies that govern charitable bankruptcies are different from those that govern commercial bankruptcies. In the second section, I will lay out a road map for determining ownership issues, indicating what questions must be answered and in what order. Finally, I will briefly discuss the role that each of the different sources of law play in answering these questions.

I. Charitable Organizations in Bankruptcy

⁴ I was Director of the Division of Public Charities for the Commonwealth from 1979 to 1984.

Bankruptcy is a routine feature of commercial life. A business enterprise entails risk and risks that turn out badly entail losses. Losses are primarily borne by owners of an organization to the extent of their capital. This is only fair. The owners' potential upside gain in any profits balances their potential downside loss in the case of failure. When a business goes bankrupt, however, some losses are imposed on creditors in the form of bad or discharged debt. American bankruptcy law has always tried to minimize these losses by insisting that creditors get a clear priority in the proceeds of a bankruptcy estate.⁵ Because of this clarity, each party to a transaction starts with the same expectations about the distribution of possible losses and each is free to strike bargains and position themselves relative to these anticipated outcomes. With charitable organizations, however, the distributional equities are somewhat different and this difference generates a number of issues that do not arise in a commercial bankruptcy.

Charitable funds do not represent a financial investment. Donors do not contribute them with the expectation of profit. Rather, their interest is to further a charitable cause. Once their donation is complete,⁶ they have no legal interest in the fund they created. The reason for this is that, by definition, a charitable trust benefits the indefinite public.⁷ For example, if the purpose of a trust is to pay the educational expenses of John Doe, the trust is not charitable because it benefits a specific individual. On the other hand, if I create a trust to pay educational expenses for the sons of my church's ministers, the trust

⁵ See 11 U.S.C.S. § 507 (2005) (delineating priorities in a bankruptcy proceeding).

⁶ Much of charitable giving today employs charitable remainder trusts. In these cases, so long as the donor or his beneficiaries have a financial interest in the trust, they can enforce its terms. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 1089, 111 Stat. 788, 960-61 (1997) (amending the definition of the charitable remainder trust); see Restatement (Second) of Trusts § 391 (1959) (discussing who can enforce a charitable trust).

⁷ See Fremont-Smith, *supra* note 3.

is charitable because it benefits an indefinite class of individuals.⁸ Thus, there are no specific beneficiaries of a charitable trust. Legal title to the property is vested in the trustee, while beneficial ownership resides with the indefinite public.⁹ Since there is no one member of the public who is entitled to benefit from the trust, it is necessary that the courts empower someone to enforce the fiduciary duties of the trustee. Thus, since the fifteenth century, courts have recognized the Attorney General as the proper representative of the public interest in charitable trusts. Indeed, even today, it is clear in virtually every American jurisdiction that it is up to the Attorney General to enforce the fiduciary obligations of charitable trustees?¹⁰ With respect to charitable corporations, modern case law and statutes convey a similar authority.¹¹

The non-commercial character of a charitable organization has a number of consequences in the bankruptcy context. First, it means that the Attorney General is a necessary party to any proceeding – including those in the bankruptcy court – that adjudicates the disposition of charitable funds.¹² Second, it affects the distributional equities. The situation is no longer governed by purely commercial considerations. Risks cannot be clearly prioritized by simply placing creditors ahead of “ownership” interests. To be sure, if the fund loses money, there is less left for the beneficiaries, and, in that sense, they bear the ultimate burden of loss. This does not mean, however, that all

⁸ See Restatement (Second) of Trusts 364 (1959).

⁹ Charitable corporations have a similar structure. The Board of a charitable organization has full authority to hold and manage the charities assets in fulfillment of its charitable purpose. Like the charitable trustee, however, the charitable board must use its authority in accordance with its fiduciary obligations.

¹⁰ See Fremont-Smith, *supra* note 3, at 305-306; 476-495.

¹¹ See *id.* at 305-307. In the case of a non-profit corporation, the Attorney General’s role is similar to that of shareholders in a for profit corporation who bring a derivative action. He cannot simply claim that the corporate board could have made a better decision, but must plead and prove that the board breached its fiduciary duties.

¹² See *Hankin v. Auxiliary of the Winsted Mem. Hosp. (In re Winsted Mem. Hosp.)*, 236 B.R. 556 (Bankr. D. Ct. 1999).

charitable interests must stand at the end of the line waiting to be paid, if at all, from the proceeds of the estate. Rather, some charitable interests must be factored in at the beginning because the nature of the charitable interest may prevent the asset from being included in the debtor's estate. Indeed, each charitable asset must be examined separately in order to determine whether it is legally restricted to a particular purpose. If it is, that asset can only be used to pay creditors whose claims are related to the restricted purpose.

This examination need not be as onerous as it sounds. Generally Accepted Accounting Principles (GAAP) require that charitable organizations keep their books and records in accordance with fund accounting principles.¹³ Under these principles, any organization that receives a donation for a specific charitable purpose must set up a special fund in its bookkeeping system. This fund is legally restricted in the sense that it cannot be used to pay any expense that does not fall within the designated purpose. Thus, if a hospital maintains a restricted fund for research, it will be credited each time the hospital receives a donation for research and debited when expenditures are made on behalf of the research program.¹⁴ If the hospital goes bankrupt, then the money in the restricted account can only be used to pay those creditors who have furnished goods or services for the research program. The remainder of the fund must be set aside for future

¹³ See Financial Accounting Standards Bd., Statement of Financial Accounting Standards No. 117: Financial Statements of Not-for-Profit Organizations § 5 (1996) [hereinafter S.F.A.S. No. 117]. GAAP comprise a set of basic accounting principles pertaining to business entities that are approved by the Financial Accounting Standards Board of the American Institute of Certified Public Accountants ("AICPA").

¹⁴ The only funds that are subject to legal restrictions are those that are restricted by the donor. Under fund accounting, the board may also create separate funds that are dedicated to a particular purpose. However, while such a fund may be segregated on the organization's balance sheet, these are board designated funds and the board may remove the restrictions. In a bankruptcy, these funds are generally understood to be available for general creditors. S.F.A.S. No. 117, *supra* note 13, at ¶13-14. *But see* Hunter v. St. Vincent Medical Ctr. (In re Parkview Hosp.), 211 B.R. 619 (Bankr. N.D. Oh. 1997). (holding that a separate fund did not cease to be restricted merely because some small portion of the fund came from the general fund of the organization.

research by the hospital or, if the hospital is no longer able to conduct such research, the fund should be transferred to a similar institution that will be able do so.¹⁵ In light of these considerations, the trustee of a bankrupt charity must be especially careful to note the existence of any restricted funds and to segregate them from the funds used to pay general creditors.¹⁶

This rule is not unfair. It is a simple application of the principle of donor autonomy. If a parent creates a trust for the benefit of her child and provides that it cannot be used to pay certain types of creditors, these provisions are generally honored on the principle that donors should be able to control the use of their own money.¹⁷ Similarly, when a donor makes a restricted charitable gift, there are even more reason to honor the restriction. Such a result not only guarantees donor autonomy but also encourages charitable giving by reassuring donors that their gifts will not be misapplied. And furthermore, since GAAP requires that the nature and extent of any restricted funds be disclosed on the balance sheet, creditors cannot claim that they relied on the existence of these funds in deciding to extend credit.¹⁸

In this section, we have seen that there are a number of distinctions between a bankrupt business and a bankrupt charity. In the next section, I will consider how these questions should be resolved in a federal bankruptcy proceeding.

¹⁵ If the specific charitable purpose has been rendered impossible by bankruptcy, the appropriate procedure is for the bankruptcy trustee or the Attorney General to file a *cy pres* petition with the state probate court. *See, e.g.,* Mass. Gen. Laws. Ann. ch. 12, § 8K (2005).

¹⁶ *See* McCarthy v. Bierbower (*In re* Crossroad Health Ministry, Inc.), 319 B.R. 778 (Bankr. D.C. 2005) (trust approved a grant on the condition that the funds must be used in 2004 for the purposes stated in the debtor's proposal); *see* Hunter v. St. Vincent Med. Ctr. (*In re* Parkview Hospital), 211 B.R. 619 (Bankr. N.D. Ohio 1997) (purpose of charitable trust was to further osteopathic medicine in the Toledo area).

¹⁷ Indeed, the bankruptcy statute gives the bankruptcy trustee no greater title to property than was held by the original debtor. *See infra* Section II.

II. A Road Map for Determining Ownership Questions

Once a petition has been filed, the bankruptcy court must determine what assets belong to the bankruptcy estate. In making this determination, the court is governed by section 541 of the Bankruptcy Code.¹⁹ Under 541, the general rule is that the estate includes “all legal or equitable interests of the debtor in property as of the date of the commencement of the case.”²⁰ Thus, the estate succeeds to every interest held by the debtor, but does not gain additional interests just because a petition has been filed. For example, if the debtor holds trust funds for the benefit of another, these funds continue in trust and will not be available for to pay the trustee’s personal creditors.²¹ Similarly, in the case of charitable organizations, section 541 provides that restricted assets will remain restricted.²² As a result, the trustee of a bankruptcy estate may be subject to two sets of fiduciary obligations. First, he has the normal obligation to safeguard the debtor’s assets for the benefit of creditors; and second, he has the same responsibilities as the debtor charity to ensure that charitable gifts have been properly applied. With respect to unrestricted funds, the trustee’s duty is plain – since the debts of the organization were normally incurred in furtherance of the charitable program, the unrestricted funds should

¹⁸ S.F.A.S. No. 117, *supra* note 13, at ¶14 (“Information about the nature and amounts of different types of permanent restrictions or temporary restrictions shall be provided either by reporting their amounts on the face of the statement or by including relevant details in notes to financial statements.”)

¹⁹ *See* 11 U.S.C.S. § 541 (2005).

²⁰ *See id.* § 541(a)(1). There are some exceptions to the general rule. *See id.* §541(b)(1) (property of the estate does not include any power that the debtor may exercise solely for the benefit of an entity other than the debtor); *see id.* § 541(c)(1)(A) (an interest of the debtor in property becomes property of the estate notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law that restricts or conditions transfer of such interest by the debtor); *see id.* § 541(c)(2) (a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title). Thus, by virtue of § 541(c)(2) even spendthrift trusts are recognized by this section.

²¹ *In re Auto-Train Corp.*, 53 B.R. 990, 994-95 (Dist. Ct. D.C. 1985), *aff’d*, 258 U.S. App. D.C. 151 (U.S. App. D.C. 1987); *see In re Langley*, 30 B.R. 595 (Bankr. N.D. Ind. 1983).

be used to pay them. With respect to restricted funds, however, the trustee must be sure to honor the restrictions. He may use the fund to pay certain creditors – those that furnished goods or services for the restricted purpose – but not others. If there are funds left over, such funds will remain subject to the original restriction and it will be up to the court – in some cases a state court – to determine their appropriate use. Thus, there is an important contrast between a commercial bankruptcy and a charitable one. In a commercial bankruptcy, the agenda is relatively simple – liquidate and pay. In a charitable bankruptcy, the process is more complicated since there can be no liquidation until the court has determined the extent of any equitable or charitable interests that may attach to the debtor’s assets. Similarly in a chapter 11, the process of restructuring and renegotiating cannot begin until the charitable status of the debtor’s assets has been clarified.

In a diocesan bankruptcy, there will be some question about what property belongs to the diocese and what belongs to the individual parishes. Each parish will have assets that are directly utilized for parish activities. There will be, for example, a church and its furnishings. There may also be rectories, schools, sacred objects, and various funds of money that have been raised for specific purposes. Which of these assets, if any, belong to the bankruptcy estate? To answer this question the court must address at least four separate issues:

- 1) Are the diocese and the parish two separate legal entities?
- 2) If they are separate, which of them has legal title to the property in question? Is it the parish or the diocese?

²² See 11 U.S.C.S. § 541; *see supra* note 16.

3) If legal title is in the diocese, are there equitable interests that belong to the parish? In this connection, there are two sub-questions that must be considered:

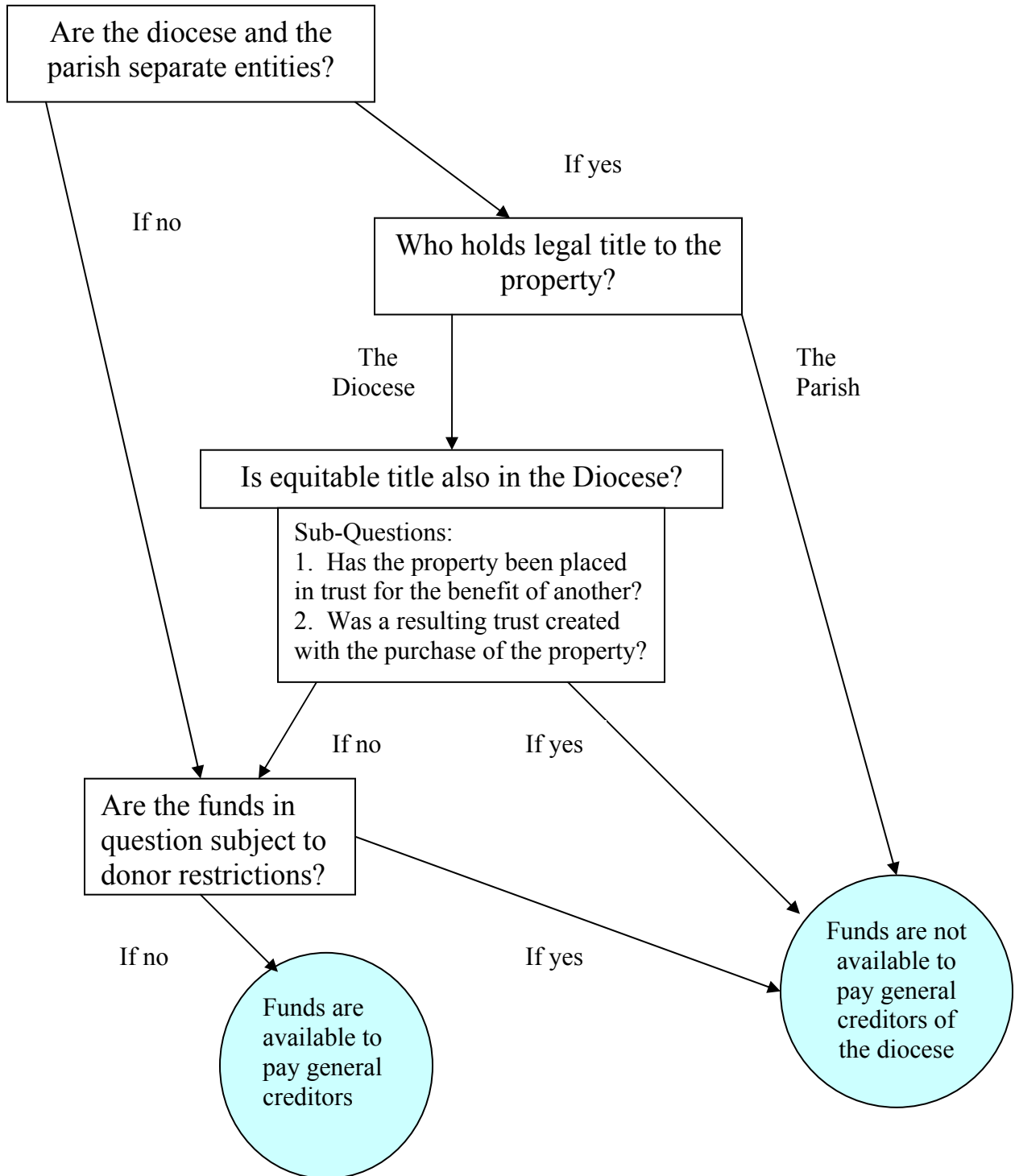
a. Did the donor of the asset convey it to the diocese expressly in trust for the benefit of the parish?

b. Was there a resulting trust created at the time the property was purchased?

4) Is the asset in question legally restricted to a particular charitable use? This question is relevant even if the parish and the diocese are the same legal entity.

These questions are interrelated in a number of ways. To help us understand the relationships, the following chart represents a proposed decision tree for sorting out ownership questions.

DECISION TREE TO DETERMINE OWNERSHIP OF CHURCH ASSETS



III. Issues that Affect Church Ownership

In this section, I will discuss each of the questions set forth in the decision tree as being necessary to determine ownership issues. As I have indicated, the resolution of these questions requires familiarity with bankruptcy law, Canon Law and the various forms of charities law. The relevance of bankruptcy law is obvious. State law is relevant because the Bankruptcy Act primarily defers to state property law in deciding who owns what.²³ It also defers to state charities law in determining the extent of charitable trusts.²⁴ Canon Law, however, is enacted by the Catholic Church and therefore poses a particular problem. Certainly, the Church cannot enact laws that are binding on American courts. Nevertheless, Canon Law is sometimes relevant to ownership disputes. This can happen in one of two ways. First, Canon Law, in its secular parts, is a kind of private ordering. For example, certain provisions of Canon Law determine the Church's structure and, in so doing, they are similar in function to corporate charter documents. Thus, in those circumstances where courts generally look to private ordering, they should regard Canon law as a relevant factor. Second, many of the issues in trust law depend upon the intent of the parties. In some cases, intent may be well documented; but, in others, courts must infer it from the circumstances. In an ambiguous case, one way to determine the expectations and intent of parties is to examine the rules that they themselves have recognized as regulating the transaction in question. Thus, Canon Law will often be relevant to determining the intent of certain actors within a Church context.

Authoritative interpretations of bankruptcy law, trust law, and Canon Law are far beyond my area of expertise. I do, however, have some familiarity with each area and, in

the remainder of this section, I will attempt to show how the legal rules in each of these areas work together to resolve ownership issues.

A. Are the diocese and the parish separate entities?

Some have claimed that a parish has no separate existence apart from that of the diocese. They argue that the diocese contains the parish as a component part. For example, one of the lawyers in the Portland bankruptcy was quoted as saying:

All parish assets are owned, including real estate, in the name of the archbishop of Portland for the Portland Archdiocese. There is no other legal entity that is the legal owner of those properties. They have always been fully owned and controlled by the archdiocese.²⁵

This is, in fact, a convenient position for the creditors to take, but it is not a correct statement of the law. Frequently, in taking this position, creditor representatives appeal to the fact that many of the dioceses are incorporated under special state statutes as “corporations sole.”²⁶ The term “corporation sole” has created much confusion. It is often read as referring to the “sole” legal existence of the diocese. The correct reading, however, is that “sole” refers to the sole authority of a bishop to direct the affairs of the diocesan corporation.²⁷ This reading is reinforced by the fact that Canon Law recognizes both the diocese and an individual parish as two separate entities. To understand Canon Law in this regard, it is necessary to understand the concept of a “juridic person.” Canon Law recognizes two different kinds of individual entities. The first is a “natural person”

²³ See *supra* note 20 (even spendthrift trusts are effective in a federal bankruptcy proceeding to the extent that they would be under state law).

²⁴ See *Hunter v. St. Vincent Medical Ctr. (In re Parkview Hosp.)*, 211 B.R. 619 (Bankr. N.D. Oh. 1997).

²⁵ Michael Morey quoted in Joseph B. Frazier, *Ore. Parishes Battle to Keep Assets*, Associated Press, May 8, 2005.

²⁶ See, e.g., Mass. Gen. L. ch. 67, § 1.

²⁷ These statutes were generally enacted at the request of the Catholic Church and reflected the fact that Canon Law confers complete authority on the bishop to conduct the affairs of the diocese. Thus, for example, the diocese does not need to have a board of directors or any of the executive officers that may be required under the state’s not-for-profit corporation law.

who is baptized into the Church;²⁸ the second is a “juridic person” that is created by the Canon Law or by decree.²⁹ Canon Law recognizes both the Diocese³⁰ and the parish³¹ as juridic persons. Dioceses are generally territorial³² although there are exceptions.³³ A parish generally represents a territorial subdivision of a given diocese.³⁴ Further, Canon Law provides for each parish to have a “parish council” and a “parish financial council”³⁵ and assigns the “pastoral care” of the parish to the parish priest acting “under the authority of the diocesan bishop.”³⁶ It also empowers the both the diocese and the parish to hold and administer property.³⁷

Canon Law, however, is not entirely decisive on the question of separate legal existence. Canon Law binds the Church; but it does not necessarily bind secular courts. Secular courts must also consider state law in determining whether the parish exists as a separate entity. One possibility, in this regard, is that the two entities are separately incorporated. If they are, this will settle the question of separate existence. If not, the issue needs further analysis. For example, Massachusetts has a statute that provides as follows:

²⁸ The New Commentary on the Code of Canon Law, c. 96 (John P. Beal et al. eds., 1998). The most recent version of the Catholic Church's canon-law code, CODEX IURIS CANONICI, was published in 1983. Although English translations of the Code are available, they are not official. The English translation relied upon for this Comment was The New Commentary on the Code of Canon Law (John P. Beal et al. eds., 1998) [hereinafter 1983 Code].

²⁹ See id. at c.114-115.

³⁰ See id. at c.369. A diocese is described as follows: “A diocese is a portion of the people of God which is entrusted for pastoral care to a bishop with the cooperation of the presbyterate so that, adhering to its pastor and gathered by him in the Holy Spirit through the gospel and the Eucharist, it constitutes a particular church in which the one, holy, catholic and apostolic Church of Christ is truly present and operative.”

³¹ See id. at c.515, § 3.

³² See id. at c.372, § 1.

³³ See id. at c.372, § 2.

³⁴ See id. at c.374.

³⁵ Id. at c.536; id. at 537.

³⁶ Id. at c.515, § 1.

³⁷ See id. at c.1255.

The deacons, wardens or similar officers of churches or religious societies, and the trustees of the United Methodist churches, appointed according to the discipline and usages thereof, shall, if residents of the commonwealth, be deemed bodies corporate for the purpose of taking and holding in succession all gifts, grants, bequests and devises of real or personal property, made either to them and their successors, or to their respective churches, if unincorporated, or to the poor of their churches.³⁸

Thus, in Massachusetts, each parish is deemed to be a corporate body whether or not it has been formally incorporated.

Another possibility to consider is the parish's status as an unincorporated association.

Courts have defined the term unincorporated association as “(1) any group whose members share a common purpose, and (2) who function under a common name under circumstances where fairness requires the group be recognized as a legal entity.”³⁹

Certainly, Roman Catholic parishes fall within this definition: they share a common purpose; they function under a common name; and, since they view themselves as a separate entities, it is fair for the law to treat them that way as well. Absent a statute, however, unincorporated associations are not entitled to hold property or to sue in their own names. For this reason, some states have enacted the Uniform Unincorporated Nonprofit Association Act, that provides for such associations to be treated as separate legal entities and permits them to hold property in their own name.⁴⁰ Thus, in order to

³⁸ Mass. Gen. L. ch. 67, § 1.

³⁹ *Barr v. United Methodist Church*, 153 Cal. Rptr. 322, 328 (1979), cert. Denied 444 U.S. 973 (1980). The precise definition of an unincorporated association varies among courts. *See also* Black's Law Dictionary 1531-32 (6th ed. 1990) (citing *Local 4076, United Steelworkers of America v. United Steel Workers of America, AFL-CIO*, 327 F. Supp. 1400, 1402-03 (1971)) (“An unincorporated association is a ‘voluntary group of persons, without a charter, formed by mutual consent for [the] purpose of promoting [a] common enterprise or prosecuting [a] common objective.’”) Another court defined “unincorporated association” as a “body of persons acting together, without a charter, but upon the methods and forms used by corporations, for the prosecution of some common enterprise.” *See Penrod Drilling Co. v. Johnson*, 414 F.2d 1217, 1222 (5th Cir. 1969) (quoting *7 C.J.S. Associations I*, at p. 19), cert. denied, 396 U.S. 1003 (1970).

⁴⁰ Unif. Unincorporated Nonprofit Association Act 1-20, 6 U.L.A. 490-507 (Supp. 1993) (passed in August of 1992 by the National Conference of Commissioners on Uniform State Laws); *see, e.g.*, Ala. Code 10-3B-1 (1996); *see* Ark. Code. Ann. 4-28-501 to -517 (Supp. 1997); *see* Colo. Rev. Stat. 7-30-101 (1994); *see* Del.

determine the status of a particular parish, it is necessary to determine whether the state in question as enacted such a law.

Finally, it must be noted how courts have handled parish property in the absence of separate incorporation or a state statutes that authorize parishes to hold property. In such cases, property is generally held either in the name of the diocese or in the name of an individual member of the parish. Sensibly enough, the courts have held that the diocese or the member do not hold the property for their own separate use. Instead, they recognize that the property is held in trust for the benefit of the parish. Thus, even in states where an unincorporated association may not hold property in its own name, it can nevertheless be the beneficiary of an enforceable trust.⁴¹ As I will argue below, this is sufficient to take parish property out of the diocesan debtor's estate.⁴²

B. Who holds legal title to the property in question?

In the last section, we saw that the parish's ability to own property in its own name depends upon state law. Since the parish is governed by Canon Law, it must also have authority from this source as well. This is one area where Canon Law functions as a kind of corporate charter. Consulting Canon Law, then, we find that it empowers each of the juridic persons within the Church to hold property.⁴³ Thus, at least so far as the Church is concerned, both dioceses and individual parishes may hold property in their own name.

Code Ann. tit. 6, §§ 1901-1919 (1999 & Supp. 2002); *see* Idaho Code sections 53-701 to -717 (1994); *see* Tex. Rev. Civ. Stat. Ann. art. 1396-70.01, 2(2) (Vernon Supp. 1996).

⁴¹ *See, e.g.,* St. Matthew's Slovak Roman Catholic Congregation v. Wuerl, 106 Fed. Appx. 761 (2004) (The real property associated with each of the former parishes was held in trust by the bishops for the benefit of the parishes' congregations).

⁴² *See infra* Section IIC.

⁴³ First, Canon Law provides for the Church itself to hold property. *See* 1983 Code c.1254, *supra* note 28 (empowering the Church to "acquire, retain, administer, and alienate temporal goods in pursuit of its proper ends." Canon 1255 provides for juridic persons within the Church to hold property ("particular churches as well as any other juridic person" are "capable of acquiring....law.") *Id.* at c.1255.

Once the ability of the parish to hold property is determined, the next question, with respect to any particular piece of property is who does own it in fact. In most cases, legal title will be a matter of record. For example, the legal owner of church real can easily be determined by a trip to the Register of Deeds. Title to bank accounts can be determined by authorizations and signature cards on file with the bank. The problem comes with various items of personal property for which there are no ownership records. Note that parish may own artwork and religious items that have a significant financial value and that creditors may wish to have the proceeds from such items applied to their claims. How then can we determine who owns what? Within the church, the answer to this question must come from Canon Law. Specifically, there are two areas of Canon Law that might be relevant. The first deals with restrictions on sacred objects;⁴⁴ the second deals with ownership generally and bests the right of ownership in that person (parish or bishop) which has lawfully acquired the property in question.⁴⁵ Thus, determining the ownership of property within the Church requires that learn more about how the item was acquired by the church.

C. If the diocese holds legal title, are there equitable interests that belong to the parish?

Legal title may not be entirely determinative of ownership interests. There are a number of equitable interests that might affect ownership rights and these are especially prevalent in the charitable and religious context. There are two theories in particular that may prompt the court to decide that certain assets are owned by the parish despite the fact

⁴⁴ See 1983 Code c.1190, § 2, *supra* note 28 (“Relics of great significance and other relics honored with great reverence by the people cannot be alienated validly in any manner or transferred permanently without the permission of the Apostolic See.”) See also *id.* at c.1269 (“If sacred objects are privately owned, private persons can acquire them through prescription...if they belong to a public ecclesiastical juridic person, however, only another public ecclesiastical juridic person can acquire them.”)

that legal title is in the name of the diocese. The first applies when the funds have been donated to the diocese subject to an express trust for the benefit of the parish. The second – a resulting trust – arises in connection with the acquisition of real property.

1. Has the donor created an express charitable trust for the benefit of a particular parish?

Generally, there are three elements to the formation of a charitable trust: the first is a gift of property that is to be the subject of the trust; the second is an intention to create the trust; and the third is a charitable purpose for the trust.⁴⁶ Suppose, for example, that I give \$1000 to Boston College in trust for the benefit of its separately incorporated rowing team and that Boston College accepts the trust. This will satisfy all the conditions of a charitable trust: There is a gift of property; the intentions of both parties are clear; and the purpose of the trust – student athletics – is generally recognized as a charitable purpose. Similarly, if the diocese and the parish are two separate entities, a donor may convey property to the diocese subject to the provisions of an express trust that benefits the parish. In such a case, these funds would not be available to pay the separate debts of the diocese.

In a case where a charitable trust has been created in accordance with legal formalities, there is little reason to worry about intent. If, however, the parties do not observe formalities, then intent must be closely analyzed. The donor's intent should not be confused with motive. Donors may give money to the diocese because they wish to provide for their local church. This does not necessarily mean that they intend to create a trust for this purpose. Perhaps their desire is only precatory – they hope that the parish will be benefited but they do not require it. Or perhaps, it is consistent with their

⁴⁵ See 1983 Code c.1256, *supra* note 28.

intention that the parish be benefited by creating a wealthier diocese. Thus, they must not only intend to benefit the parish but they also must intend to do it in a specific way – through the formation of an express trust. To determine whether a trust is intended, one must look at all the facts and circumstances that surround the gift itself. One important set of circumstances is the language that was used in soliciting the gift. Suppose, for example, that a local parish decides to raise money for building improvements and solicits for that purpose. Suppose further that it decides to place the funds with the diocese for safe keeping. Under these circumstances, it may well be said that the donor who responds to that solicitation intends and expects that his gift will become part of a fund to be held in trust by the diocese.⁴⁷ If the solicitation material is unavailable or not enlightening, the court might consider the donor’s situation at the time of the gift. What was the purpose for the gift and could it have been satisfied by the creation of an express trust? Finally, there are the historical practices and traditions associated with such gifts. If the donor is part of a community that has binding rules with respect to the treatment of gifts, then, in the absence of contrary evidence, the donor’s intent should be understood in the context of those rules. In the case of the Church, Canon Law would seem to favor the trust theory because it provides that the church must honor donor restrictions on charitable funds.⁴⁸

⁴⁶ See Fremont-Smith, *supra* note 3, at 134.

⁴⁷ Indeed, in some states, state statutes create such a trust. See, e.g., Mass. Gen. L. ch. 68, § 3.

⁴⁸ See 1983 Code c.1302 § 1, *supra* note 28. (“A person who has accepted goods in trust for pious causes either through an act inter vivos or by a last will and testament must inform the ordinary of the trust and indicate to him all its movable and immovable goods with the obligations attached to them. If the donor has expressly and entirely prohibited this, however, the person is not to accept the trust.”) Note, however, that the Catholic Church has seemed on occasion to violate this rule. For example, in Wheeler v. Roman Catholic Archdiocese, 378 Mass. 58, cert. denied, 444 U.S. 899 (1979), the parishioners of a local church filed suit against the Archdiocese of Boston, alleging that they had donated money to build a cemetery and that the Archdiocese had converted the property to low income housing over the local church’s objection. The Massachusetts court

B. In the case of real property, was there a resulting trust created when the property was purchased?

If A buys property for B, using funds provided by B and A takes the property in his own name, then A will hold the property in a resulting trust for B unless the parties intend a different result. With a resulting trust, the holder of title is not entitled to the proceeds from the sale of the property and therefore it cannot be sold to satisfy his creditors.⁴⁹ Further, if A declares bankruptcy, the property will not become part of the bankruptcy estate.

It is not hard to see how a resulting trust might arise in the case of parish real estate. Suppose, for example, that there is a church whose membership has outgrown its current building. They decide that a larger church is necessary and raise the funds to pay for it. Lacking lawyers and real estate expertise, they ask the diocese to find and purchase an appropriate piece of property. To simplify matters, the diocese and the parish agree that the diocese should take title in its own name. In such a case, the requirements of a resulting trust are met. Controversy may arise, however, in cases where the intent of the parties is not clear. Did the parish intend to make a gift to the diocese or was it merely asking the diocese to act on its behalf? In a commercial context, one can often tell that a resulting trust was intended because of the implausibility of the gift scenario. On the other hand, in a charitable context, the intent to donate is less implausible and the court may find it necessary to dig deeply into the factual circumstances surrounding the transfer.

4. If the diocese holds legal title, is the property in question subject

declined to exercise jurisdiction because of the constitutional limits on civil court involvement in church disputes.

to donor restrictions?

The last question that must be considered is the issue of a restricted fund. As discussed above, a restricted fund is created whenever a donor gives money to a charitable organization and stipulates that it must be used for a particular charitable project. In addition, we have seen that such funds cannot be used to pay creditors whose claims are unrelated to the restricted purpose. Indeed, this rule has been explicitly recognized in bankruptcy proceedings. In re Parkview Hospital⁵⁰ is a good illustration of this principle. In Parkview, the debtor osteopathic hospital maintained a separate account for research activities. The creditors maintained that the account was not subject to legal restrictions and was therefore available to pay general creditors. In deciding the issue, the court recognized that Ohio trust law was controlling and it therefore framed the issue as it believed an Ohio court would frame it:

When a non-profit organization seeks donations for a (specific) charitable purpose, an understanding can be found between the donors and the non-profit corporation that the donations are to be used for the charitable purpose. The issue is whether such an understanding manifests an intent to legally bind the non-profit corporation to so use the funds, or was simply a hopeful desire or suggestion for the ultimate use.⁵¹

Then, after examining the solicitation materials, the facts surrounding some of the gifts and the Board's historical treatment of the funds, it concluded that the fund was restricted.⁵²

⁴⁹ See *supra* note 21.

⁵⁰ Parkview, 211 B.R. 619.

⁵¹ *Id.* at 634. In addition, the court held that the fact that the organization itself had contributed to the fund – both directly and indirectly by placing contributions in the fund – did not matter because Ohio law authorized charitable organizations to contribute money to other charitable funds.

⁵² See Parkview, 211 B.R. 619 at 628-629. The court's resolution of a second issue is also instructive. The second issue that the court faced was that the Fund had been maintained over a long period of time and had received contributions in many different ways. Some of the gifts were donor designated for the research fund. Others were unrestricted and simply placed in the fund by the organization's board of directors. Noting that Ohio state law permitted charitable organizations to contribute funds in trust for a charitable purpose, the court reasoned that the fact that some of the funds had been board designated, rather than donor designated, did not destroy the binding nature of the charitable fund. Thus, for example, a "building

When we apply this ruling to church property, we can see that the key question that must be addressed is the intention of the parties. What expectations did the donor have about the treatment of his gift? What responsibilities did the church think it was assuming when it accepted the gift? This issue is one of fact and will vary with the circumstances. A clear case would arise when a donor gives money to the diocese and stipulates that it may only be used for parish purposes. A more ambiguous case might arise when the fundraising take place over an extended period of time and where there is little evidence of what was said in each solicitation. Such cases may present an irreducible ambiguity unless one considers the context in which the donation was made. Specifically, in the Catholic Church, one might want to consider its historical practice with respect to donations. In this respect, the provisions of Canon Law seem relevant. If I give money for a particular purpose and I know that Canon Law treats such donations as restricted gifts, then presumably I have intended that result. And, indeed, Canon Law is clear with respect to the binding nature of donor restrictions.⁵³ Since this is the longstanding rule, courts should presume that donor gifts made to the church for a particular purpose are mandatory rather than precatory absent evidence to the contrary. In this context, no one – not the diocese, the parish or the member-donors – would believe that it was necessary to spell out the type of restriction that had been created

Before leaving this issue, it is important to note that the existence of a restricted fund would not be precluded by a finding that a particular diocese and a particular parish are,

fund” that is being safeguarded by the diocese does not cease to be a restricted fund simply because the diocese may have contributed some of its own money to the fund.

⁵³ Specifically, it provides that any gifts made by church members for a definite purpose must, in fact, be applied to that purpose. *See supra* note 48. Canon Law also creates a presumption that any money that is given to an administrator is presumed to be given for the use of a juridic person (the diocese or the parish) rather than for the administrator’s personal expenses. Thus, even cash handed to a priest may be presumed

in fact, the same entity. Restricted funds do not cease to be restricted simply because there is no legally distinct third party to receive the funds. If the Diocese receives funds for a particular parish, it must segregate the funds in its accounting system and maintain safeguards so that they cannot be used to pay diocesan expenses. The effect of this is to create a fund that can only be used to benefit the parish whether or not that parish has a separate legal existence.

Conclusion

The focus of this paper has been ownership issues in the bankruptcy context. Ownership issues also arise when individual parishes split away from the general church. This has happened with some frequency as schisms develop over controversial areas of church doctrine. Obviously, ownership issues in bankruptcy cases must be decided in accordance with principles that apply in the schism cases as well. Nevertheless, there are at least two important differences between these two types of case. One is the schism cases rarely pit diocese against parish. The more usual case is between one group of parishioners who want to stay in the diocese and a second group – usually a larger group – who want to disaffiliate. Thus, the question is not diocesan ownership but rather which group of parishioners controls the parish church. The second difference is that the schism cases frequently raise issues that relate to religious doctrine and practice. Since the first amendment prevents courts from addressing religious questions, the courts must be resourceful in resolving the property

to be for the benefit of the parish and if the priest turns around and deposits it with the diocese, he is presumed to do so for that particular purpose.

dispute without reference to the underlying religious dispute.⁵⁴ There have been two approaches to this problem. One approach avoids religious controversy entirely by adopting a *neutral principles of law* approach. Under this approach, the court must decide the question based upon the deeds to the properties, state statutes that deal with implied trusts, and church property rules. Thus, for example, in Jones v. Wolf,⁵⁵ the Georgia court ruled for the parish by simply looking to record title and noting the absence of any indication that an express trust had been created for the benefit of the diocese.⁵⁶ The second approach is based upon the distinction between hierarchical and congregational churches. This requires that the court examine religious doctrine only so far as is necessary to determine whether ultimate authority is in the diocese or the parish.⁵⁷ If it is in the diocese, the court will defer to the diocese's resolution of the issue; if it is in the parish, then the judgment of the congregation should be determinative.⁵⁸

Classifying the church as hierarchical or congregational makes little sense in the bankruptcy context where the property dispute is not based upon religious controversy. I have therefore followed a neutral principles approach in this paper. Beyond this, however, it is important to consider one aspect of the schism cases. Suppose, for example, that a parish of the Catholic Church wishes to leave the diocese and take its real estate with it. Prior to these bankruptcies, courts have generally held that the Roman Catholic Church is a hierarchical church and they have therefore deferred to the diocese in property disputes.⁵⁹

⁵⁴ Serbian v. Orthodox Diocese v. Milivojevich, 426 U.S. 696, 609-10 (1976); Presbyterian Church in U.S. v. Mary Elizabeth Blue Hull Mem. Presby. Church, 393 U.S. 440, 449 (1969).

⁵⁵ Jones v. Wolf, 443 U.S. 595 (1979).

⁵⁶ *See id.* at 599.

⁵⁷ *See* Parish of the Advent v. Protestant Episcopal Diocese, 426 Mass. 268 (1997); *see* Weaver v. Wood, 2 Mass L. Rep. 522 (1994); *see* Pentacostal Christian Church of Boston v. Sanchez, 12 LCR 120 (2004).

⁵⁸ *See id.*

⁵⁹ *See* Watson v. Jones, 80 U.S. 679, 723-26 (1872) (Watson represents the Supreme Court's first confrontation with internal church dispute. The court looked to the hierarchical policy within the Presbyterian Church in

However, the several dioceses of the Church have now taken the position that the parish assets belong to the parish. It would seem then that, if there were schism cases down the road, the Church's present position would strengthen the hand of the parish. In addition, its position adds a possible complication to the hierarchy/congregational split.. In The Russian Orthodox Church Outside Russia V. The Russian Orthodox Church Of The Holy Resurrection, Inc.⁶⁰ the trial court ruled that the Russian Orthodox Church was "hierarchical in terms of internal administration, discipline and matters of faith," but "congregational as far as the control and use of its property."⁶¹ In approving this ruling, the Court of Appeals noted a number of factors including the fact that there had been a "pattern of considerable movement in and out of the Church by individual parishes who took with them their own property without claim by the Church."⁶² In essence, the church's own practice in this regard eventually bound it to continue the practice. Thus, the deference to hierarchy approach does not protect hierarchical churches from rulings they do not like. It merely allows them to adopt a consistent position with respect to ownership issues.

I make this point in conclusion because I think it illustrates an important point about the wider controversy surrounding the Catholic Church. The sexual abuse crisis is a true disaster for the Church – one that cannot simply be shrugged off in the Bankruptcy Court. It has resulted not only in financial liability but also in parish closures, priest shortages, and individual congregations that are reexamining their connection to religious authority. In this context, legal disputes will surely arise. For example, one parish in Massachusetts has

resolving the dispute); *see* *Serbian v. Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 609-10 (1976) (also reflecting the Supreme Court's early deferential approach to the church).

⁶⁰ *Primate & Bishops' Synod of the Russian Orthodox Church Outside Russia v. The Russian Orthodox Church of the Holy*, 35 Mass. App. Ct. 194 (1993).

⁶¹ *Id.* at 194.

⁶² *Id.* at 200.

already been to the Supreme Judicial Court in an attempt to prevent its closure.⁶³ In the past, the courts have attempted to avoid any case that had religious overtones, but disaster has brought demands for accountability and demands for accountability means more litigation. This litigation will pose many challenges both for the Roman Catholic Church and for the courts. Understanding the intersection of Church law and civil law will be a necessary prerequisite to meeting these challenges.

⁶³ See *Akoury v. Roman Catholic Archbishop of Boston*, 18 Mass. L. Rep. 271 (2004). (The plaintiffs, members of the St. Albert the Great Church and Parish in Weymouth sought to prohibit the closure of their Church and Parish by an archbishop attempting to reconfigure the archdiocese due to numerous serious problems that the archdiocese was facing. The court held that the members showed that great irreparable harm would be suffered by them as a result of the closing of their parish. The church indicated that it complied with the spirit and letter of canon law in the closing of the parish. The court held that there was no evidence of wrongdoing or unjust enrichment on the part of the church, and that the closing of a parish was a matter of judgment for the archbishop to make which the court could not second guess.)