Secured Credit in Religious Institutions' Reorganizations

Pamela Foohey
SECURED CREDIT IN RELIGIOUS INSTITUTIONS’ REORGANIZATIONS

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I. INTRODUCTION

The high-profile Chapter 11 cases of American Airlines, General Motors, and Lehman Brothers have underscored the increasing influence of secured creditors in the reorganizations of large corporations. Drawing from the outcomes of these and other prominent cases, scholars and practitioners increasingly assume that most businesses enter Chapter 11 with a high percentage of secured debt, which leads to a high percentage of cases ending in the sale of the debtor’s assets under § 363 of the Bankruptcy Code (“363 sales”)1 rather than with confirmation of reorganization plans through the more traditional use of the Chapter 11 process.2 This perception of the evolving landscape of Chapter 11 raises questions about the extent to which blanket liens and rapid 363 sales permit secured creditors to capture going-concern value.3 Indeed, partially in response to claims about “the end of bankruptcy,”4 the American Bankruptcy Institute (“ABI”) formed a commission to study current uses of Chapter 11 and to offer recommendations for the reform of business reorganization.5

However, evidence and discussions about “the end of bankruptcy” center on secured creditors’ role in the reorganizations of very large cor-

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5. ABI Commission to Study the Reform of Chapter 11, Am. Bankr. Inst., http://commission.abi.org (last visited Apr. 4, 2015). In spring 2014, the ABI and the University of Illinois College of Law co-hosted a symposium of bankruptcy scholars with the purpose of discussing secured creditors’ rights and role in modern Chapter 11. I served as a moderator during the symposium. Papers presented during the symposium are forthcoming in the University of Illinois Law Review.
porations. Though most of the asset value administered in Chapter 11 comes from cases filed by large companies, the vast majority of cases are filed by smaller businesses. The few analyses of cross-sections of Chapter 11 proceedings suggest that secured creditor control is not nearly as omnipresent as asserted and that 363 sales are not as dominant as assumed. In considering the ABI commission’s recommendations and future proposals for legal reforms, it is crucial to understand how Chapter 11 serves the full range of distressed businesses, not merely the large corporations that are the usual subjects of discussions about the importance of 363 sales and secured creditor control.

This Essay adds empirical evidence to the debate by highlighting how one subset of debtors—religious organizations—whose main creditors typically are secured lenders have used the reorganization process. I report data culled from all the Chapter 11 cases filed in districts in the fifty United States and the District of Columbia by religious institutions from the beginning of 2006 to the end of 2013—a total of 689 cases filed by 618 unique religious organizations. I also draw from in-depth interviews I conducted with seventy-six attorneys who represented 109 of the 454 unique religious organizations that filed their Chapter 11 cases between 2006 and 2011.

By focusing on 363 sales and other indices of creditor control (such as successful motions to lift the stay), plan proposal and confirmation rates, recoveries to creditors, and postbankruptcy survival rates, I establish that the traditional negotiated Chapter 11 case is alive and thriving among these debtors. The data suggest that these cases preserved significant value for secured creditors, while distributing value to unsecured creditors. My findings thus contradict the predicted outcomes of these cases based on claims about the effect of secured creditors’ ability to reach going-concern value through blanket liens. They also demonstrate

6. See Baird & Rasmussen, supra note 4, at 756 (concluding with “a few brief observations about small firms and corporate reorganizations.”).


8. See Warren & Westbrook, supra note 7, at 604-06. Westbrook, supra note 2, at 833-35 (reporting data from a cross-section of Chapter 11 cases filed in 2006).

9. I use terms such as “religious organization” to mean any organization whose operations are motivated in a meaningful way by religious beliefs and principles. See Pamela Foxhey, Bankrupting the Faith, 78 Mo. L. REV. 719, 720 n.3 (2013).

10. For a description of methodology, see id. at 730-32. I used the same methodology to identify cases filed in 2012 and 2013. The dataset is on file with the author.

11. For a description of how I solicited and conducted an initial round of interviews with those attorneys who represented religious organization debtors that filed in the 10 federal jurisdictions with the greatest percentages of religious organizations’ Chapter 11 filings between 2006 and 2011, see Pamela Foxhey, When Churches Reorganize, 88 AM. BANKR. L.J. 277, 281-83 (2014). I used the same methodology to solicit and conduct a second round of interviews with attorneys who represented religious organization debtors that filed in the remaining federal jurisdictions between 2006 and 2011. Transcripts of interviews are on file with the author.
that recommendations for legal reforms must keep in mind that a variety of businesses use Chapter 11 and that any calls for changes to Chapter 11 need to account for the divergences in these uses or be narrowly tailored to different types of debtors.

I offer this analysis as a supplement to research about large cases. Concentrating on religious organizations’ cases necessarily presents a narrow view of secured creditors’ role in Chapter 11 cases. Even so, the results show that further empirical examinations may yield insights that diverge from current understandings of how creditor control impacts modern reorganization, and what that control means for reforms of Chapter 11.

II. RELIGIOUS ORGANIZATION DEBTORS’ FINANCIAL CHARACTERISTICS

The religious organizations that filed under Chapter 11 during the study time frame had financial profiles consistent with smaller businesses. They also entered bankruptcy with one or two prepetition interests securing nearly all of their assets. This characteristic suggests that the religious organization debtors may be comparable to the supposed common Chapter 11 debtor that is controlled by a secured creditor through a prepetition security interest covering almost all of its assets. Table 1 summarizes the religious organizations’ key financial characteristics upon entering Chapter 11.12

12 Monetary numbers are reported in constant December 2013 dollars using the Consumer Price Index (CPI-U) tables as published on a monthly basis. Archived Consumer Price Index Detailed Report Information, Bureau of Labor Statistics, http://www.bls.gov/cpi/cpi_dr.htm (last visited Apr. 3, 2015). Asset and debt figures are based on 593 debtors’ schedules that included figures for both assets and debts. If an organization filed more than once during the study’s timeframe, its assets and debts are included in the calculation as many times as it filed and submitted schedules. The mean and median number of priority and unsecured creditors figures exclude 7 cases with over 200 priority creditors or over 200 general unsecured creditors. As evident in Table 1, the data is skewed by several debtors with large amounts of assets and debts.
TABLE 1: FINANCIAL CHARACTERISTICS OF RELIGIOUS ORGANIZATION CHAPTER 11 DEBTORS

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets, $</td>
<td>2,885,887</td>
<td>1,285,930</td>
</tr>
<tr>
<td>Real Property, $</td>
<td>2,556,313</td>
<td>1,193,899</td>
</tr>
<tr>
<td>Personal Property, $</td>
<td>334,263</td>
<td>52,785</td>
</tr>
<tr>
<td>Total Debts, $</td>
<td>2,262,654</td>
<td>1,045,229</td>
</tr>
<tr>
<td>Debts Secured by Real Property, $</td>
<td>1,825,089</td>
<td>890,806</td>
</tr>
<tr>
<td>Total Secured Debts, $</td>
<td>1,881,950</td>
<td>924,957</td>
</tr>
<tr>
<td>Priority and Unsecured Debts, $</td>
<td>380,703</td>
<td>50,093</td>
</tr>
<tr>
<td>Total Debts to Assets</td>
<td>1.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Real Property Secured Debts to Real Property</td>
<td>0.9</td>
<td>0.7</td>
</tr>
<tr>
<td>Number of Creditors Secured by Real Property</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Number of Secured Creditors</td>
<td>3.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Number of Priority and Unsecured Creditors</td>
<td>10.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Notably, the debtors’ main assets were real property, generally a church building, which they claimed was worth a median of 96% of their total assets. They owed creditors holding security interests in these buildings a median of 93% of the debtors’ total debt. Typically one creditor was secured by this real property, often along with some or all of the debtor’s personal property. Overall, three-quarters of the debtors held equity cushions in their real property, while 69% claimed that they entered bankruptcy solvent.

Consistent with their financial profiles, the vast majority of the religious organizations stated that they filed for bankruptcy with the primary goal of saving their buildings from foreclosures in order to preserve their equity and congregations. Significantly, most of the debtors were small Christian congregationalist or nondenominational churches that were unable to look to overarching governing bodies for financial support.

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13. One-third of debtors had loans secured by their real property outstanding to two or more creditors. But even in cases with multiple secured creditors, on average, the debtor owed one creditor 76% of the balance due on the real property. Evidencing the breadth of some secured creditors’ collateral, some creditors’ liens led to cash collateral fights. See Foohey, supra note 11, at 295-96.

14. See id. at 277 n.7 (defining “equity cushion”). 429 of 572 debtors with scheduled real property claimed that the property was worth more than they owed to creditors secured by it. 408 of 593 debtors claimed that the value of their assets was greater than the total amount that they owed to creditors.

15. Of the 530 debtors that cited a reason for their filing in any document submitted to the court, 442 (83%) stated they filed to save their property from foreclosure.

16. Of the 689 debtors, 51% were nondenominational Christian churches and 44% were churches affiliated with Christian denominations. See Foohey, supra note 9, at 736-37 (discussing nondenomin-
lectively, these characteristics suggest that secured creditors may view the Chapter 11 process as an opportunity to sell their collateral. At the very least, usually one creditor had the potential to wholly control the case through its secured position, making the religious organizations’ cases comparable to the effectively one-party collective proceedings that are thought to dominate Chapter 11.

III. 363 Sales and Other Indices of Creditor Control

If 363 sales are on the rise, it seems reasonable to posit that 363 sales of substantially all of the debtor’s assets would have occurred in at least a significant minority of religious organizations’ cases.17 Contrary to this assumption, as detailed in Table 2, only 9% of the religious organizations’ cases involved any 363 sale.18 Most of these sales were not of substantially all of the debtors’ assets, but of spare real property, such as smaller homes or vacant lots, or of vehicles.

The few sales that occurred seemed to be part of traditional Chapter 11 reorganizations and liquidations. In 48% (30) of the cases involving sales, the debtor went on to propose a reorganization plan. In 15% (9) of the cases involving sales, the debtor later or concurrently proposed a liquidation plan.

### TABLE 2: 363 Sales and Secured Creditor Motions in Religious Organizations’ Chapter 11 Cases

<table>
<thead>
<tr>
<th>Event</th>
<th>N</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>363 Sale of Asset(s)</td>
<td>62</td>
<td>9.0</td>
</tr>
<tr>
<td>Secured Creditors Filed One or More Motions to Lift Stay</td>
<td>342</td>
<td>49.6</td>
</tr>
<tr>
<td>Parties Resolved One or More Motions to Lift Stay</td>
<td>180</td>
<td>26.1</td>
</tr>
<tr>
<td>Court Denied One or More Motions to Lift Stay</td>
<td>42</td>
<td>6.1</td>
</tr>
<tr>
<td>Court Granted One or More Motions to Lift Stay</td>
<td>172</td>
<td>25.0</td>
</tr>
<tr>
<td>Secured Creditor Filed Motion to Dismiss</td>
<td>88</td>
<td>12.8</td>
</tr>
<tr>
<td>Court Granted Motion to Dismiss</td>
<td>49</td>
<td>7.1</td>
</tr>
</tbody>
</table>

17. The debtor’s status as a religious organization could have led creditors to view a 363 sale as preferable to foreclosing under state law. Selling nonperforming assets through bankruptcy may bring less public scrutiny, while removing what had become a precarious loan from the creditor’s books. See Foohey, supra note 11, at 294-95 (summarizing attorneys’ thoughts as to why secured creditors would not want to follow through with threatened or initiated foreclosures). Alternatively, the debtor’s status could have counseled the creditor against pushing for a sale, even under section 363, if the possibility existed that the organization’s leaders and members could fix its problems such that the organization had sufficient funds to pay the creditor going forward.

18. Table 2 reports the frequency (N) of each event and percentage (%) of all 689 religious organization Chapter 11 cases in which the event occurred.
Although creditor control is not apparent in the frequency of 363 sales, creditor control may be observable in other aspects of the cases. Creditors may have filed motions to lift the automatic stay so they could foreclose on the assets outside of bankruptcy,19 or sought dismissal of the cases. In some respects, religious organizations’ Chapter 11 cases resemble single-asset real estate cases.20 Some creditors pointed out this similarity to bankruptcy courts in motions to lift the stay or dismiss based on an argument that the cases were disputes between the debtor and one or two parties that should not be resolved through bankruptcy’s collective action proceeding.

But when the prevalence and outcomes of motions to lift the stay and motions to dismiss are considered, clear secured creditor control is not evident. Also as summarized in Table 2, in half of the cases, creditors secured by real property filed one or more lift stay motions.21 However, in 65% of the cases in which these motions were filed, the parties came to an agreement for adequate protection payments during the pendency of the proceeding or the court denied at least one of the motions.

Creditors secured by real property filed even fewer motions to dismiss. They requested that the court dismiss the case in only 13% of the proceedings. Courts granted 56% of these motions. Considered together, bankruptcy courts either lifted the stay or dismissed the case, thereby allowing secured creditors access to their collateral, in 32% of all religious organization Chapter 11 cases. In religious organizations’ cases, contrary to predictions based on claims about “the end of bankruptcy” that religious organizations’ secured creditors would use their control positions to sell or gain access to their collateral, secured creditors’ effectively blanket liens did not result significant numbers of sales or successful attempts to access collateral.

IV. PLANS: PROPOSAL, CONFIRMATION, AND CREDITOR RECOVERIES

The frequency with which religious organization debtors filed and confirmed plans supports the lack of other indices of significant secured creditor control. As summarized in Table 3,22 in 45% of the religious organization cases, debtors filed reorganization or liquidation plans. This result again is at odds with the claim that debtors rarely use Chapter 11 to achieve a negotiated settlement via a reorganization plan. Bankruptcy courts confirmed reorganization or liquidation plans in 25% of all reli-

20. See Foohey, supra note 9, at 768-70 (discussing religious organization cases’ similarities to single-asset real estate cases).
21. In 67 cases, creditors secured by real property filed more than one motion to lift the stay. These creditors filed at total of 432 motions to lift the stay.
22. Table 3 reports the frequency (N) of each event and percentage (%) of all 689 religious organization Chapter 11 cases in which the event occurred.
gious organization Chapter 11 cases. In this set of bankruptcies, a sizable portion of cases were resolved by the “traditional” means of a negotiated settlement via a reorganization plan.

**Table 3: Outcomes of Religious Organizations’ Chapter 11 Cases Based on Court Records**

<table>
<thead>
<tr>
<th>Outcome</th>
<th>N</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reorganization Plan Filed and Confirmed</td>
<td>162</td>
<td>23.5</td>
</tr>
<tr>
<td>Liquidation Plan Filed and Confirmed</td>
<td>11</td>
<td>1.6</td>
</tr>
<tr>
<td>Court Approved Consensual Resolution Among Parties</td>
<td>64</td>
<td>9.3</td>
</tr>
<tr>
<td>Reorganization Plan Filed, Not Confirmed, Case Dismissed</td>
<td>112</td>
<td>16.3</td>
</tr>
<tr>
<td>Liquidation Plan Filed, Not Confirmed, Case Dismissed</td>
<td>2</td>
<td>0.3</td>
</tr>
<tr>
<td>No Plan, Case Dismissed</td>
<td>262</td>
<td>38.0</td>
</tr>
<tr>
<td>Reorganization Plan Filed and Pending</td>
<td>20</td>
<td>2.9</td>
</tr>
<tr>
<td>No Plan, Case Pending (as of September 2014)</td>
<td>56</td>
<td>8.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>689</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Reorganization plans provided substantial recoveries to unsecured creditors. Given that most of the religious organization debtors claimed to hold equity cushions in their real property and that many claimed to be solvent, the reorganization plans proposed should have provided recovery to unsecured creditors, up to 100% recovery in some cases. Consistent with this financial profile, proposed plans restructured secured loans and often arranged to pay unsecured creditors a large portion of their claims over the course of the plan—an average of 61% and a median of 100% of the dollar value of their claims.

Of confirmed reorganization plans, 48% provided unsecured creditors with a 100% dividend over the length of the plan. The average recovery to unsecured creditors under confirmed plans was 65% of the dollar value of their claims. If secured creditors had foreclosed on their

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23. This percentage reflects a plan confirmation rate similar to previous reports of plan confirmation in Chapter 11 cases filed by smaller businesses. See Foohey, *supra* note 11, at 300. Larger debtors historically have higher confirmation rates. See Anne Lawton, *Chapter 11 Triage: Diagnosing a Debtor’s Prospects for Success;* 54 *ARIZ. L. REV.* 985, 1018 (2012) (using a random-sample of Chapter 11 cases filed in 2004 to analyze plan confirmation rates and finding that debtors with total debts of $5 million or more had a 55% plan confirmation rate versus a 29% plan confirmation rate for debtors with total debts of less than $5 million, for a combined plan confirmation rate of 34%).


25. Of 294 proposed reorganization plans, 29 (10%) did not include recoveries to unsecured creditors because the debtor did not owe them any money, and 23 (8%) did not clearly disclose recoveries to unsecured creditors and are omitted from the calculations. If the plan stated a recovery range, I based calculations on the range’s midpoint. If the plan stated a dollar value recovery, I calculated the recovery based on the value of unsecured claims as stated in the plan or disclosure statement.

26. Of 162 confirmed reorganization plans, 78 paid unsecured creditors in full.
collateral, given the results of auctions, it is unlikely that unsecured creditors would have received similar percentage recoveries, if they received anything at all. Again contrary to claims about “the end of bankruptcy,” in this subset of cases, not only did the presence of one or two secured creditors with liens on effectively all of the debtors’ assets result in the consensual resolutions that typify a “traditional” Chapter 11 proceeding, but those resolutions also preserved (and perhaps created) considerable value for unsecured creditors.

V. POSTBANKRUPTCY OUTCOMES

Interviews with religious organization debtors’ attorneys revealed that the Chapter 11 process facilitated even more negotiated settlements outside of the plan process than was evident by relying on court records alone. As presented in Table 4, of the 109 cases that interviewed attorneys handled, 31% resulted in a confirmed reorganization plan and an additional 21% ended with a consensual resolution between the debtor and its creditors.27

| TABLE 4: OUTCOMES OF RELIGIOUS ORGANIZATIONS’ CHAPTER 11 CASES HANDLED BY INTERVIEWED ATTORNEYS |
|---------------------------------------------------|--------|-------|
| Reorganization Plan Confirmed                    | 34     | 31.2  |
| Agreement with Creditors During Case             | 21     | 19.3  |
| Dismissed; Issues Resolved Later                 | 2      | 1.8   |
| Dismissed; Assets Foreclosed / Sold or Issues Unresolved | 52     | 47.7  |
| Total                                            | 109    | 100.0 |

According to attorneys, these consensual resolutions allowed the religious organizations to continue operating in their prepetition locations and pay unsecured creditors. Thus, more than half of the cases handled by interviewed attorneys were resolved by the “traditional” means of a negotiated settlement. Though the attorneys interviewed may have represented debtors whose cases had slightly higher successful negotiation rates than the overall population of debtors,28 this figure again suggests

27. If the attorney did not know what happened to a debtor, the resolution of that debtor’s case is categorized as unresolved. In 2% of cases in which the court dismissed the case before the debtor came to a resolution with its creditors, the debtor and its creditors began negotiations while the case pended and asked the court to dismiss the case when it became clear that finalizing their agreement would be easier and less expensive without seeking court approval of the settlement.

28. That interviewed attorneys handled cases with a higher overall reorganization plan confirmation rate than the plan confirmation rate among all religious organization debtors indicates that those attorneys who agreed to be interviewed may have represented debtors with characteristics that made them more likely to succeed than the entire population of religious organization debtors.
that the specter of significant secured creditor control that impedes the
Chapter 11 process may not be as prevalent as assumed.

These negotiated settlements most often allowed the religious or-
ganizations to remain operating in their prepetition locations. As pre-
sented in Table 5, at the time of the interviews, which spanned from April
2013 through April 2014, 60% of the attorneys’ religious organization
debtor clients remained operating.

| TABLE 5: POST-BANKRUPTCY OPERATIONS OF INTERVIEWED ATTORNEYS’
RELIGIOUS ORGANIZATION DEBTOR CLIENTS |
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating in Pre-Petition Location</td>
</tr>
<tr>
<td>Relocated and Operating</td>
</tr>
<tr>
<td>No Longer Operating</td>
</tr>
<tr>
<td>Attorney No Longer in Contact with Client</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Ninety percent (all but two) of the debtors with confirmed plans
were operating from their original locations. The other two organizations
had moved, but remained open. The other debtors that had relocated
usually had used whatever money they received from postdismissing fore-
closures and sales of their real property to lease spaces in close proximity
to their prepetition locations. Religious organization debtors’ longer-term
survival again suggests that these more traditional Chapter 11 cases po-
tentially created more value for secured and unsecured creditors than if
the debtors’ assets had been disposed of through 363 sales.

VI. CONCLUSION

The outcomes of religious organizations’ Chapter 11 cases show that
the presence of creditors with security interests covering almost all of the
debtors’ assets does not automatically lead to widespread 363 sales, as
typically is assumed. Rather, in this subset of cases, debtors and secured
creditors negotiated during the proceeding, resulting in plans and settle-
ments. Recoveries to creditors through these plans and settlements, and
religious organization debtors’ longer-term survival, further suggest that
these debtors’ use of Chapter 11 allowed for the preservation of going-
core concern value.

Scholars have raised concerns that blanket liens and rapid 363 sales
may allow secured creditors to capture going-concern value that possibly

29. This calculation excludes 6 cases in which the debtor confirmed a plan because the attorneys
had lost contact with the organizations.
belongs to unsecured creditors. Management and the Chapter 11 process itself also may create value to which secured creditors perhaps do not have claims. The results of the religious organization cases bolster arguments that secured creditors’ stake in Chapter 11 cases requires closer scrutiny.

Religious institutions’ cases provide a perspective of reorganization that does not align with prevailing views of how Chapter 11 currently works. Though religious organizations may be unique, other subsets of debtors whose cases also are not consistent with prominent descriptions of the rise of 363 sales and secured creditor control may exist. Further empirical investigations of cross-sections and subsets of Chapter 11 cases may show that modern reorganization is much more diverse and intricate than apparent through analyzes and explanations of what happens in the largest Chapter 11 proceedings. Knowing how the full range of business debtors and their creditors use the Chapter 11 system is particularly crucial before any legal reforms to Chapter 11 that will affect all business debtors are enacted. Without such understandings, reforms may inadvertently disrupt productive, value-creating reorganizations.


30. See sources cited supra note 3.