IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF IOWA
DAVENPORT DIVISION

In the matter of DIOCESE OF DAVENPORT, Debtor.	Chapter 11 Case No. 06-02229-lmj11 Honorable Lee M. Jackwig

MEMORANDUM OF LAW IN SUPPORT OF APPROVAL OF DISCLOSURE STATEMENT AND CONFIRMATION OF JOINT PLAN OF REORGANIZATION

COMES NOW, Diocese of Davenport, as Debtor and Debtor-in-Possession (the "Diocese") by its attorneys, Lane & Waterman LLP, and for its Memorandum of Law in Support of Approval of Disclosure Statement and Confirmation of Joint Plan of Reorganization, and respectfully states as follows:

I. INTRODUCTION

At the hearing in the above-captioned matter on March 5, 2008, the Court indicated that the Debtor should demonstrate subject matter jurisdiction over the Tort Claims against the Catholic Entities and the Court's authority to issue the injunctions set forth in the Plan. This Memorandum of Law is presented to assist the Court with regard to those issues.

II. LAW AND ARGUMENT

A. THIS COURT HAS SUBJECT MATTER JURISDICTION OVER THE TORT CLAIMS AGAINST THE CATHOLIC ENTITIES.

1. This Court should follow Eighth Circuit law and reject the narrow reasoning of the Third Circuit in *Federal-Mogul Global, Inc.*[1]

[1] In its Objection to the Disclosure Statement Century Indemnity cites the Court to *In re Federal-Mogul Global, Inc.*, 300 F.3d 368 (3rd Cir. 2002) and *In re Johns-Manville Corp.*, 208 U.S. App. WL 399010 (2nd Cir. 2008) for the proposition that the "related to" jurisdiction under 28 U.S.C. § 1334(b) is lacking where the only claim related to a Title 11 case is a contingent claim. However, the Bankruptcy Appellate Panel for the Eighth Circuit rejected the Third Circuit's reasoning in

This Court's subject matter jurisdiction over the Tort Claims against the non-debtor Catholic Entities stems from 28 U.S.C. § 1334(b), which provides:

> Except as provided in subsection (e)(2) [(not relevant here)], and notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or ***related to cases under title 11***. (emphasis added).

The Eighth Circuit has adopted the "conceivable effect" test first espoused in *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) for determining whether a civil proceeding is "related to" a Title 11 case. This test was first adopted by the Eighth Circuit in *Natl. City Bank v. Coopers & Lybrand*, 802 F.2d 990, 994 (8th Cir. 1986). The test is summarized as follows:

> [T]he test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could **conceivably have any effect on the estate being administered in bankruptcy. ... An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action ... and which in any way impacts upon the handling and administration of the bankruptcy estate.**

Safeco Ins. Co. of Am. v. ADM/Farmland Indust., Inc. (In re Farmland Indust., Inc.), 296 B.R. 793, 804 (8th Cir. B.A.P. 2003)(quoting *Dogpatch Prop., Inc. v. Dogpatch U.S.A., Inc. (In re Dogpatch U.S.A., Inc.)*, 810 F.2d 782, 786 (8th Cir. 1987) (citing *Pacor*, 743 F.2d at 994)) (emphasis added). The "conceivable effect" language is interpreted liberally in the Eighth Circuit: "even a proceeding which portends a mere contingent or tangential effect on a debtor's estate meets the broad jurisdiction test articulated in *Pacor*." *Farmland Indust.*, 296 B.R. at 804-805 (quoting *Natl. Union Fire Ins. Co. of Pitt. Pa. v. Titan Energy, Inc.*, 837 F.2d 325, 330 (8th Cir. 1988)). The existence of "related to" subject matter jurisdiction is broader in a case under

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Federal-Mogul in its decision in *In re Farmland Indust., Inc.*, 296 B.R. 793, 806-7 (8th Cir. B.A.P. 2003).

Chapter 11: "jurisdiction of bankruptcy courts may extend more broadly in [a Chapter 11 case] than in [a Chapter 7] case." *Farmland Indust.*, 296 B.R. at 805 (quoting *Celotex Corp. v. Edwards*, 514 U.S. 300, 309 (1996)).

In *Farmland Industries*, a non-debtor surety sought a determination as to whether it was required to pay certain non-debtor parties pursuant to bonds purchased by the debtor. *Farmland Indust.*, 296 B.R. at 796-799. The bankruptcy court dismissed the action but retained the claims against the debtor pending the outcome in another forum of whether the non-debtor parties were entitled to payment under the bonds. *Id.* at 798-799. On appeal, ADM, a non-debtor party, made the argument that the claim against the debtor was contingent and therefore the bankruptcy court had no subject matter jurisdiction under 1334(b). *Id.* at 806-807. ADM urged the court to follow the Third Circuit's application of the *Pacor* "conceivable effect" test in *In re Federal-Mogul Global, Inc.*, 300 F.3d 368 (3d Cir. 2002). The Bankruptcy Appellate Panel for the Eighth Circuit directly rejected Third Circuit's narrow reasoning in *Federal-Mogul*:

> We disagree with the Appellee's argument that there is no jurisdiction because the claim is merely contingent or subject to further suit. *Titan Energy* very much suggests otherwise. *See also Lindsey v. O'Brien, Tanski, Tanzer and Young Health Care Prov. (In re Dow Corning Corp.)*, 86 F.3d 482, 494 (6th Cir. 1996)("The potential for [the debtor] being held liable to the nondebtors in claims for contribution and indemnification, or vice versa, suffices to establish a conceivable impact on the estate in bankruptcy."). We think *Celotex* dictates this result and that the bankruptcy court too narrowly distinguished it. (*Farmland Indust.*, 296 B.R. at 806).
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> ADM's reliance on *Federal-Mogul* is misplaced for several reasons. First, it should be noted that, and as the court itself pointed out, **the decision in *Federal-Mogul* is directly at odds with the Sixth Circuit's decision in *Dow Corning*** where the court ruled that similar pending lawsuits against that debtor should be allowed to proceed in bankruptcy court even though the contribution claims had to be litigated at a later time. *Dow Corning,* 86 F.3d at 494. **Second, and most importantly, while the Third Circuit discussed the *Pacor* ruling at length and gave every indication that it would make the same ruling if the matter came before it, the court specifically did not decide the jurisdictional issue**. The

> discussion of *Pacor* was, therefore, dicta, strong though it was. **Moreover, we have difficulty squaring the dicta in *Federal-Mogul* with the Eighth Circuit's decisions on this subject. Third, the case is contrary to a number of other decisions on the same issue**. *See In re WorldCom, Inc. Securities Litigation,* 293 B.R. 308, 320 (S.D.N.Y.2003)("jurisdiction over a third party action exists where a claim for indemnification or contribution arising from that litigation has a conceivable effect on a bankruptcy proceeding."); *Michigan Employment Sec. Comm'n v. Wolverine Radio Co., Inc.(In re Wolverine Radio Co.*), 930 F.2d 1132, 1143 (6th Cir.1991) (holding that a contractual indemnification provision supported jurisdiction even though the debtor "would not be affected until and unless [the third party] invoked the indemnification" provision); *Arnold v. Garlock, Inc.,* 278 F.3d 426, 440 (5th Cir.2001) (generally approving of "related to" jurisdiction for contribution claims in the mass tort context, but declining to enter stay of the remand of third-party actions where the removing defendant had not shown a likelihood of success on any contribution claim); *Randall & Blake, Inc. v. Evans (In re Canion),* 196 F.3d 579, 586-87 (5th Cir.1999) (third party litigation that might decrease the claims against the estate is related to bankruptcy); *A.H. Robins v. Piccinin,* 788 F.2d 994, 1001 (4th Cir.1986) (actions are related to bankruptcy when brought against officers of debtor who may be entitled to indemnification under debtor's insurance policy). And finally, the defendants in *Federal-Mogul* (as did the Defendant in *Pacor*) had claims for contribution that had to be the subject of separate litigation between them and the debtor manufacturer. The initial suits between the claimants and the suppliers would not necessarily bring into question factual issues regarding the liability of the manufacturer. Nor did the claimants, like Safeco, have the immediate right to make a claim for an administrative expense in the bankruptcy case should they be found liable in the underlying lawsuits. For all these reasons, we decline to follow the court's reasoning in *Federal-Mogul.* (*Farmland Indust.*, 296 B.R. at 807)(emphasis added).

In other words, there are two interpretations of the *Pacor* "conceivable effect" test: (1) the narrow interpretation of the Third Circuit in *Federal-Mogul*, and (2) the broader interpretation of the Sixth Circuit in *Dow Corning*. *See W.R. Grace & Co. v. Chakarian (In re W.R. Grace & Co.)*, 366 B.R. 295, 299-300 (Bankr. D. Del. 2007). The Third Circuit narrowed the "conceivable effect" test by holding in *Federal-Mogul* that contingent claims do not give rise to "related to" jurisdiction of the bankruptcy court, whereas the Sixth Circuit interpretation holds subject matter jurisdiction exists over such contingent claims because they could conceivably have an effect on the estate.[2] It is clear that the Eighth Circuit follows the broader interpretation of the Sixth Circuit. *Farmland Indust.*, 296 B.R. at 807; *Kocher v. Dow Chemical Co.*, 132 F.3d 1225, 1230-1231 (8th Cir. 1997). This compels the Court to follow the Eighth Circuit law in applying the broader "conceivable effect" test and reject the *Federal-Mogul* narrow reasoning.

2. The Catholic Entities hold claims against the Debtor and Vice Versa

Iowa law provides that the Debtor and Catholic Entities hold claims against each other that, at the very least, could conceivably affect the Estate.

Under Iowa law, the general equitable right of restitution encompasses contribution, indemnity and subrogation. *State, Dept. of Human Services ex rel. Palmer v. Unisys Corp.*, 637 N.W.2d 142, 156 (Iowa 2001). Iowa has long adhered to the commonly accepted theory that contribution is available between concurrent tortfeasors when those tortfeasors have a common liability to the injured party. *Rees v. Dallas County*, 372 N.W.2d 503, 504 (Iowa 1985).[3] This long-standing rule is now codified in Iowa's Comparative Fault Act: "A right of contribution exists between or among two or more persons who are liable upon the same indivisible claim for the same injury, death, or harm, whether or not judgment has been recovered against all or any of them." Iowa Code § 668.5(1)(2008). "Contribution rests on common liability, not on joint

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[2] Century Indemnity states that *Farmland Indust.* is not controlling authority and does not undermine its jurisdictional argument based on *Pacor*. However, Eighth Circuit stated that "even a proceeding which portends a mere contingent or tangential effect on a debtor's estate meets the broad jurisdictional test articulated in *Pacor*." *In re Titan Energy, Inc.*,327 F.3d 829, 830 (8th Cir. 1988); *See Kocher v. Dow Chemical Co.*, 132 F.3d 1225, 1231 (8th Cir. 1997)(citing *Dow Corning's* holding that contingent contributions claims against the a Debtor fall within related to jurisdiction under § 1334(b)). In fact, no Eighth Circuit case holds that a surety relationship is required to trigger "related to" jurisdiction under 1334(b).

[3] Concurrent tortfeasors are those individuals whose "separate fault combine, so that, when viewed as a whole, the fault proximately caused plaintiff's injuries." *Foggia v. Des Moines Bowl-O-Mat*, 543 N.W.2d 889, 893 (Iowa 1996).

negligence or joint tort." *Federated Mut. Implement & Hardware Ins. Co. v. Dunkelberger*, 172 N.W.2d 137, 142 (Iowa 1969). "Common liability exists when the injured party has a legally cognizable remedy against both the party seeking contribution and the party from whom contribution is sought." *McDonald v. Delhi Sav. Bank*, 440 N.W.2d 839, 841 (Iowa 1989); *Rees*, 372 N.W.2d at 504. It is "a liability which may be enforced against each tortfeasor independently." *Telegraph Herald, Inc. v. McDowell*, 397 N.W.2d 518, 520 (Iowa 1986) (common liability exists where injured party could sue each party directly).

The Perpetrators (mostly clergy) were assigned by the Diocese to their positions at the Catholic Entities thereby giving rise to the Tort Claims against the Diocese for negligent supervision under Iowa agency law. *Kiesau v. Bantz*, 686 N.W.2d 164, 171-172 (Iowa 2004); *Restatement (Second) of Agency* § 213 (1957). Concurrently, these same Perpetrators were employees of the Catholic Entities where they were assigned, thereby giving rise to Tort Claims against the Catholic Entities for negligent supervision and respondeat-superior under Iowa employer/employee law. *Id.* Further adding to the common or concurrent tort liability, the Diocese and the Catholic Entities shared many common officers and directors. The Bishop was, and is, the president of the Diocese and also president of each of the individual Parishes and most other Catholic Entities. The Vicar General was, and is, an officer of the Diocese and each of the Parishes and the Articles of Incorporation give the Bishop the authority to remove directors without cause. Both the Bishop and the Vicar General were, and are, two (2) of the five (5) members of the Board of Directors of the Diocese and each of the Catholic Entities. These facts clearly create common liability for negligent supervision of the Perpetrators by both the Diocese and the Catholic Entities, since it is the same individuals (the Bishop and Vicar General) who had a duty of supervision and were officers of both the Diocese and Catholic Entities at the same relevant times. The liability of each is combined through the dual roles of the Diocese personnel. Both the Diocese and the Catholic Entities can be held liable for the same acts – sexual abuse on minors based on the concurrent torts of the Diocese and the Catholic Entities. It is irrelevant whether the Tort Claims are pursued against the Debtor and Catholic Entities under similar or different legal grounds or theories. *Allied Mut. Ins. Co. v. State*, 473 N.W.2d 24, 27 (Iowa 1991). The proximate cause of the liability to the Tort Claimants was the concurrent torts of both the Diocese and the Catholic Entities. It is impossible to distinguish the negligent acts of the common officers and directors between the Diocese, on one hand, and the Catholic Entities, on the other hand. Under these facts, the Diocese and the Catholic Entities hold claims for contribution against each other for the same "indivisible claim" resulting in the same injuries to the same Tort Claimants.

3. Eighth Circuit case law, and the case law relied on by those decisions, support a finding of "related to" jurisdiction in this case.

In *Farmland Industries*, the court noted that "[a]s was the case in *Dogpatch*, the resolution of the Safeco/ADM dispute will necessarily involve a determination of Debtor's liability to ADM and will trigger Debtor's liability to Safeco for indemnity, as a consequence of which there is a conceivable effect [sic] on the bankruptcy reorganization." 296 B.R. at 806. The same is true in this case. The liability of the Catholic Entities for the Tort Claims creates contribution claims between the Diocese and the Catholic Entities because they are joint tortfeasors sharing common liability for an indivisible claim giving rise to the same injury.

In re Dow Corning Corp., 86 F.3d 482 (6th Cir. 1996) is similar to the facts here. In *Dow Corning*, the Chapter 11 Debtor (Dow Corning), its two non-debtor shareholders, and other non-debtor manufacturers of silicone gel-filled breast implants, sought to remove to federal court, and transfer to the Eastern District of Michigan, all personal injury actions filed against the non-debtor entities as a result of injuries sustained from faulty implants. *Id.* at 485-486. The district court ruled that it only had jurisdiction over the claims against Dow Corning, and not over claims asserted against the non-debtors. *Id.* at 487. The Sixth Circuit reversed. *Id.* at 498.

The Sixth Circuit premised its analysis with the recognition by the United States Supreme Court that "Congressional intent was 'to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate.'" *Id.* at 489 (quoting *Celotex*, 514 U.S. 300). The court applied the "conceivable effect" test articulated in *Pacor* and noted "[a] proceeding 'need not necessarily be against the debtor or against the debtor's property' to satisfy the requirements for 'related to' jurisdiction." *Id.* (quoting *Pacor*, 743 F.2d at 994).

The non-debtors in Dow Corning presented, *inter alia*, their basis for "related to" jurisdiction as follows:

> [The non-debtors] argue that, despite the fact that they have not yet filed contribution and indemnification claims or proofs of claim relating to implant litigation in Dow Corning's bankruptcy case, they have contingent claims for contribution and indemnification that will have a conceivable effect on the bankruptcy proceedings. ... In addition, the nondebtor defendants claim that Dow Corning may itself have claims against them for contribution and indemnification under theories of joint and several liability.

Id. at 490. The district court rejected this argument finding "the possibility of contribution should only be regarded as relevant if and when judgments are actually entered against the nondebtors." *Id.* The Sixth Circuit distinguished the outcome of *Pacor* on its facts and found the district court's application of "related to" jurisdiction to be too narrow:

> Based on the principles outlined above, we believe the district court has "related to" subject matter jurisdiction over the breast implant claims pending against the nondebtor defendants in this case. Thousands of suits asserted against Dow Corning include claims against the nondebtors, and the nature of the claims asserted establishes that Dow Corning and the various nondebtor defendants are closely related with regard to the pending breast implant litigation. Dow Chemical

> and Corning Incorporated have already asserted cross-claims against each other and Dow Corning in the underlying litigation, and the other nondebtor defendants have asserted repeatedly throughout their briefs, motions, and oral arguments that they intend to file claims for contribution and indemnification against Dow Corning, and we have no reason to doubt the veracity of those assertions at this time.
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> We find that it is not necessary for the appellees first to prevail on their claims against the nondebtor defendants, and for those companies to establish joint and several liability on Dow Corning's part, before the civil actions pending against the nondebtors may be viewed as conceivably impacting Dow Corning's bankruptcy proceedings. The claims currently pending against the nondebtors give rise to contingent claims against Dow Corning which unquestionably could ripen into fixed claims. **The potential for Dow Corning's being held liable to the nondebtors in claims for contribution and indemnification, or vice versa, suffices to establish a conceivable impact on the estate in bankruptcy. Claims for indemnification and contribution, whether asserted against or by Dow Corning, obviously would affect the size of the estate and the length of time the bankruptcy proceedings will be pending, as well as Dow Corning's ability to resolve its liabilities and proceed with reorganization. In addition, we believe there is a qualitative difference between the single suit involved in *Pacor* and the overwhelming number of cases asserted against Dow Corning and the nondebtor defendants in this case.** A single possible claim for indemnification or contribution simply does not represent the same kind of threat to a debtor's reorganization plan as that posed by the thousands of potential indemnification claims at issue here. *Id.* at 493-494 (emphasis added).

See also In re Titan Energy, Inc., 837 F2d 325, 330 (8th Cir. 1988) (holding that "even a proceeding which portends a mere contingent or tangential effect on a debtor's estate meets the broad jurisdictional test articulated in *Pacor*"); *Kocher v. Dow Chemical Co.*, 132 F3d 1225, 1231 (8th Cir. 1997) (holding that a claim against Dow Corning's non-debtor shareholder presented a claim which was "related to" Dow Corning's bankruptcy because it was at least arguable that the claim conceivably could effect Dow Corning's bankruptcy estate through a claim for contribution or indemnity); *Abramowitz v. Palmer*, 999 F.2d 1274, 1278 (8th Cir. 1993) ("the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy . . . an action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options or freedom of action

. . . and which in any way impacts upon the handling and administration of the bankrupt estate") (quoting *In re Dogpatch* at 786). The Eighth Circuit has stated:

> Bankruptcy courts are to be an efficient means of disposing of a debtor's entire bankruptcy estate and any "interpretation of the 'related to' jurisdiction must avoid the inefficiencies of piecemeal adjudication and promote judicial economy by aiding in the efficient and expeditious resolution of all matters connected to the debtor's estate." *Palmer*, 999 F.2d at 1278. (quoting *In re Lemco Gypsum, Inc.*, 910 F.2d 784, 787 (11th Cir. 1990)).

Similarly to *Palmer*, above, without a resolution of the Tort Claims against the Catholic Entities, the Bankruptcy Court cannot fully and fairly adjudicate the rights and liabilities of the Debtor. In this case, the Debtor's rights, liabilities, options or freedom of action are directly impacted by the Tort Claims against the Catholic Entities. Tort Claims brought against the Catholic Entities will certainly give rise to contribution or indemnity claims against the Diocese; Tort Claims against the Catholic Entities will impact the insurance coverage available to the Diocese by dissipating the value of the policies and depleting the insurance funds available for distribution under the Plan to the detriment of the Diocese's creditors; and Tort Claims against the Catholic Entities brought in a haphazard manner will impede the Diocese's reorganization efforts by limiting its freedom of action to negotiate a settlement with the Diocese's insurers because many of them also insure the Catholic Entities.

Under well-established Eighth Circuit jurisprudence, the claims against the Catholic Entities clearly fall within the "related to" jurisdiction under § 1334(b).[4] The Catholic Entities

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[4] Numerous other courts hold that contribution or indemnity claims fall within the "related to" jurisdiction. *See e.g., In re Celotex Corporation*, 124 F.3d 619 (4th Cir. 1997) (holding that related to jurisdiction does not require certain or likely impact on handling and administration of the bankruptcy estate (citing *Titan Energy, Inc.*); *In re El Paso Refinery, L.P.*, 302 F.3d 343 (5th Cir. 2002) (holding that a non-debtor indemnity claim against a non-debtor could conceivably have an effect on the bankruptcy estate in light of a chain of indemnity provisions leading directly to the debtor); *In re WorldCom, Inc. Securities Litigation*, 293 B.R. 308 (S.D.N.Y. 2003) (stating that "the argument that any claim for contribution or indemnification must be reduced to

and the Debtor hold claims for contribution or indemnification against each other that necessarily affect the Estate by potentially dissipating the assets and frustrating the Diocese's reorganization efforts and the administration of the Settlement Trust.[5] Moreover, the Tort Claimants hold claims against the Catholic Entities and the Debtor as joint tortfeasors. This fact alone has been held sufficient to confer jurisdiction over the Tort Claims. *Abramowitz v. Palmer*, 999 F.2d 1274, 1280 n.3 (8th Cir. 1993)(citing *In re Wood*, 825 F.2d 90, 94 (5th Cir. 1987) ("when the plaintiff alleges liability resulting from the joint conduct of the debtor and non-debtor defendants, bankruptcy jurisdiction exists over all claims under section 1334").

Both the Catholic Entities and Settling Insurers have agreed to make significant contributions to the Diocese for distribution to Tort Claimant through the Settlement Trust created under the Plan. The contributions of the Catholic Entities and Settling Insurers constitute $25.4 million of the $37 million settlement fund. These settlement contributions are the linchpin to the Plan. Without these contributions, settlement with the Tort Claimants would be impossible and years of insurance coverage litigation and property of the Estate litigation would ensue, as happened in both the Spokane and Portland Catholic Diocese bankruptcy cases.

The Catholic Entities' contributions are contingent upon receiving the benefit of the Permanent Injunction Against Prosecution of Channeled Claims under the Plan. The Settling Insurers contribution of $19.5 million is expressly conditioned upon receiving the benefit of the Settling Insurer Injunction under the Plan. The Catholic Entities and Settling Insurers' insistence

judgment to provide a basis for jurisdiction can be swiftly rejected . . . if the litigation . . . had already been concluded and resulted in a judgment . . . then the effect of their contribution claims on the bankruptcy proceeding would not simply be "conceivable" it would be certain.").

[5] "'[A]utomatic' liability of the estate is not the *sine qua non* for related to jurisdiction; all that is necessary is that there could 'conceivably' be some effect upon the estate as a consequence of the litigation in question." 1 *Collier on Bankruptcy*, ¶ 3.01[4][c], at 3-28 (15th ed. rev. 2007) (discussing the Sixth Circuit's holding in *Dow Corning*).

on the injunctions as a condition to settlement is sufficient to find that the non-debtor liability could have an effect on the Estate. *See Munford v. Munford (In re Munford)*, 97 F.3d 449, 453-454 (11th Cir. 1996)(settling non-debtor's insistence that non-settling, non-debtors be enjoined from asserting claims against it was sufficient to confer related to jurisdiction over the potential claims of the non-settling, non-debtors).

Accordingly, under the broad reach of "related to" jurisdiction in Title 11 cases as interpreted by the Eighth Circuit, this Court has subject matter jurisdiction over potential Tort claims against and liability of the Catholic Entities and Settling Insurers.

B. THIS COURT HAS THE POWER TO CONFIRM THE PLAN ENJOINING TORT CLAIMS AGAINST THE CATHOLIC ENTITIES AND SETTLING INSURERS.

1. Eighth Circuit case law, and the great weight of Circuit Court authority, approves the granting of a non-debtor channeling injunction under similar circumstances.

The seminal case providing for third-party injunctions prohibiting direct claims against non-debtors is *In re A.H. Robins Co., Inc*, 880 F.2d 694 (4th Cir. 1989).[6] In *A.H. Robins*, over 195,000 claimants sought damages from the debtor, its directors and attorneys, its insurer, and its insurer's attorneys, for injuries sustained as a result of a defective contraception device (the Dalkon Shield). *In re A.H. Robins Co., Inc.*, 88 B.R. 742, 743-744 (E.D. Va. 1988). Like the Plan here, the Chapter 11 plan in *A.H. Robins* provided releases for certain non-debtors (A.H. Robins' directors and attorneys, its insurer, and its insurer's attorneys), 880 F.2d at 700-701, and created

[6] The origin of the reasoning applied in *Robins* is found in *MacArthur Co. v. Johns-Manville Corp.*, wherein the bankruptcy court "enjoined all suits against the [debtor's] insurers" concerning certain insurance policies. 837 F.2d 89, 91 (2d Cir. 1988), *cert. denied*, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988). The court reasoned that the claims were not extinguished but "simply channeled away from the insurers and redirected at the proceeds of the settlement." *Id.* at 90. The court found support for its authority to issue a channeling injunction in 11 U.S.C. § 105(a) and concluded that because the settlement was "essential … to a workable reorganization, it falls well within the bankruptcy court's equitable powers." *Id.* at 94.

settlement trusts to provide compensation for tort claimants, 88 B.R. 750-751, who, like the Tort Claimants in this action, held claims that were unliquidated, 880 F.2d at 697. Claimants who chose to opt-out of the plan held claims against the non-debtors as joint tortfeasors, and therefore challenged the constitutionality of the third-party injunctions. *Id.* at 701. The Fourth Circuit Court of Appeals affirmed the district court's confirmation of the *A.H. Robins* reorganization plan. The Fourth Circuit reasoned:

> Bankruptcy courts are courts of equity. See *NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 527, 104 S.Ct. 1188, 1196, 79 L.Ed.2d 482 (1984). 11 U.S.C. § 105(a) gives a bankruptcy court the power to issue "any order, process or judgment that is necessary or appropriate to carry out the provisions of this title," and confers equitable powers upon the bankruptcy courts. *In Matter of Old Orchard Inv. Co.,* 31 B.R. 599 (W.D. Mich. 1983). Given the impact of the proposed suits on the bankruptcy reorganization and the fact that the class B members who chose to opt-out could have had their claims fully satisfied by staying within the settlement, the bankruptcy court's equitable powers support the questioned injunction. **We think the ancient but very much alive doctrine of marshalling of assets is analogous here. A creditor has no right to choose which of two funds will pay his claim. The bankruptcy court has the power to order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors.** *Columbia Bank for Cooperatives v. Lee,* 368 F.2d 934, 939 (4th Cir. 1966), cert. denied, 386 U.S. 992, 87 S.Ct. 1308, 18 L.Ed.2d 338 (1967); *IV Minor's Institutes* 1248 (1883). ... It is essential to the reorganization that these opt-out plaintiffs either resort to the source of funds provided for them in the Plan and *Breland* settlement or not be permitted to interfere with the reorganization and thus with all the other creditors. Since they have chosen opt-out rather than payment in full, they may have no complaint about a restriction placed on their ability to sue others. Permitting a suit by them in violation of the Plan is a defeat of the Plan and a resulting defeat of the other creditors. "Particularly since the insurance settlement/injunction arrangement was essential in this case to a workable reorganization, it falls within the bankruptcy court's equitable powers 'which traditionally have been invoked to the end that ... substance will not give way to form, that technical considerations will not prevent substantial justice." *MacArthur Co. v. Johns-Manville Corp.,* 837 F.2d 89, 94 (2nd Cir. 1988), cert. denied, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988), quoting *In re U.N.R. Industries, Inc.,* 725 F.2d 1111, 1119 (7th Cir. 1984).

880 F.2d at 701-702. (emphasis added).

A.H. Robins and its progeny were followed in the Eighth Circuit in *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930, 934-937 (W.D. Mo. 1994).[7] The court in *Master Mortgage* set forth what is now the most authoritative formulation of a five-factor balancing test for determining whether a Chapter 11 plan containing a non-debtor injunction may be confirmed.

> The first factor to be considered is whether there is an identity of interest between Master Mortgage and the entities to be protected by the injunction. ... The second factor to be considered is whether the non-debtor has contributed substantial assets to the reorganization. ... Factor three considers whether the injunction is essential to the reorganization. ... Factor four considers creditor approval of the injunction. ... Finally, factor five considers whether the Plan provides for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.

Id. at 937-938. The *Master Mortgage* court allowed the channeling injunction because the non-debtors held indemnity and contribution claims against the debtor, the non-debtors had contributed substantial assets to the estate, the injunction was essential to the reorganization, the creditors overwhelmingly voted in favor of the plan, and the plan provided for payment of all or substantially all of the claims affected by the injunction. *Id.* The same is true in this case.

The Catholic Entities hold contribution claims against the Debtor (and vise versa) and have contributed substantial assets to the Estate – $5.9 million and their Travelers insurance policies – to the Settlement. The channeling injunction prohibiting further Tort Claims against the Catholic Entities is essential to both the settlement with the Tort Claimants under the Plan and the Diocese's own reorganization. The Diocese relies on ongoing income from the Catholic Entities to fund 72% of its annual budget. Under Canon Law, the Catholic Entities have a duty to support the Diocese and the Bishop by providing funds for their operations. The Diocese has no other independent source of significant income. Even though the Diocese and the Catholic

[7] Eighth Circuit support for the decision in *A.H. Robins* is also found in *In re Security Services, Inc.*, 203 B.R. 708, 711-712 (W.D. Mo. 1996), wherein a creditor was barred from proceeding against the debtor for the sole purpose of recovering against the debtor's insurer.

Entities are separate Iowa non-profit corporations (with no members or shareholders) their structure under Canon law is similar to a for-profit holding company which is wholly dependent the upstream flow of funds from its operating subsidiaries to support the parent company.

If the Tort Claimants were allowed to proceed with their claims against the Catholic Entities and obtain large judgments against them, it would deplete the assets and contributions upon which the Diocese is dependent for its reorganization and fresh start. In other words, like the plan in *Master Mortgage*, "[t]he assets contributed by [the Catholic Entities] form the foundation of the Plan," and "[j]ust as the settlement is the linchpin of the Plan, the injunction is the cornerstone of the settlement." *Id.* at 938. Moreover, the Plan is expected to be approved by a very substantial majority of the Debtor's creditors. The Plan is supported by the Committee and Unknown Claimants Representative and provides a mechanism for the payment of all or substantially all of the claims affected by the injunction. Like the *Master Mortgage* plan, "[a]ll five factor weigh towards the issuance of a permanent injunction in this case." *Id.*[8] Based on the foregoing, this Court has the necessary powers under section 105(a) to issue the Permanent Injunction Against Prosecution of Channeled Claims and the Settling Insurer Injunction.

2. The interpretation of the Bankruptcy Code supports the granting of a non-debtor channeling injunction and is not inconsistent with Section 524(e) as a non-debtor discharge.

11 U.S.C. § 105(a) is the primary source of this Court's general equitable power. That statute provides:

[8] The *Master Mortgage* test was recently applied again in the Eighth Circuit in *In re Hoffinger Indust., Inc.*, 321 B.R. 498, 513-514 (E.D. Ark. 2005) (denying injunction for non-debtors). *Hoffinger* is distinguishable from this case because there was *no* evidence that the debtor and non-debtors shared an identity of interest or that the injunction was essential to the reorganization. *Id.* at 514. Moreover, the plan in *Hoffinger* did not provide the amounts to be contributed by the non-debtors and it failed to provide for the payment of all or substantially all of the claims affected by the injunction. *Id.*

> *The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.* No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. (emphasis added).

Section 105(a) is also the primary source of authority that bankruptcy courts have relied upon to enjoin third-party claims against a non-debtor. *See Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 985 (1st Cir. 1995); *SEC v. Drexel Burnham Lambert Group, Inc., (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *Official Comm. of Unsecured Creditors v. Bechtel, (In re Labrum & Doak)*, 237 B.R. 275, 305 (Bankr. E.D. Pa. 1999); *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. at 934-937; *In re Transit Group, Inc.*, 286 B.R. 811, 815-818 (Bankr. M.D. Fla. 2002); *In re Heron, Burchette, Ruckert & Rothwell*, 148 B.R. 660, 685 (Bankr. D.D.C. 1992). The sound reasoning of these courts is buttressed by the United States Supreme Court's interpretation of section 105(a).

In *U.S. v. Energy Resources Co., Inc.*, 495 U.S. 545, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990), the Internal Revenue Service ("IRS") appealed the decision of the First Circuit Court of Appeals upholding a bankruptcy court order requiring the IRS to apply a Chapter 11 debtor's tax payments to the debtor's trust fund tax debt.[9] IRS policy allows taxpayers who make voluntary payments to designate the tax liability to which the payment will apply, whereas taxpayers who make involuntary payments are afforded no such right. *Id.* at 548. The IRS contended in *Energy Resources* that the Chapter 11 payments were involuntary and therefore it could apply the tax

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[9] Taxes withheld from employees' paychecks by employers are referred to as "trust fund" taxes because they are held in trust for the government. *Energy Resources*, 495 U.S. at 546-547. If the employer fails to remit the taxes, the IRS may collect the outstanding sums from the individuals who are responsible for collecting the tax. *Id.* at 547.

payments to non-trust fund tax debts, thereby improving the chances that the non-guaranteed, non-trust fund tax debts will be paid. *Id.* at 550.

> The First Circuit concluded, however, that even if the payments were properly characterized as involuntary under the IRS's regulations, the Bankruptcy Courts nevertheless had the authority to order the IRS to apply an 'involuntary' payment made by a Chapter 11 debtor to trust fund tax liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan.

Id. The IRS contended that the bankruptcy court's order conflicted with its ability to collect delinquent taxes as protected by the Code. *Id.* at 549. Specifically, the IRS noted that "the Code provides a priority for specified tax claims, including those at issue in this case, and makes those tax debts nondischargeable[,]" and "requires a bankruptcy court to assure itself that reorganization will succeed[.]" *Id.*

The Supreme Court prefaced its analysis with a patent recognition of the broad equitable powers afforded bankruptcy courts under the Bankruptcy Code.

> The Bankruptcy Code does not explicitly authorize the bankruptcy courts to approve reorganization plans designating tax payments as either trust fund or nontrust fund. The Code, however, grants the bankruptcy courts residual authority to approve reorganization plans including "any ... appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C. § 1123(b)(5) [(now 1123(b)(6)]; see also § 1129. The Code also states that bankruptcy courts may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. § 105(a). These statutory directives are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships. See *Pepper v. Litton,* 308 U.S. 295, 303-304, 60 S.Ct. 238, 243-244, 84 L.Ed. 281 (1939); *United States National Bank v. Chase National Bank,* 331 U.S. 28, 36, 67 S.Ct. 1041, 1045, 91 L.Ed. 1320 (1947); *Katchen v. Landy,* 382 U.S. 323, 327, 86 S.Ct. 467, 471, 15 L.Ed.2d 391 (1966).

Energy Resources, 495 U.S. at 549. The Supreme Court held that the limitations to the bankruptcy court's authority cited by the IRS did not explicitly prohibit the order issued by the bankruptcy court, and therefore the order was well within the court's equitable powers.

> It is evident that these restrictions on a bankruptcy court's authority do not preclude the court from issuing orders of the type at issue here, for those restrictions do not address the bankruptcy court's ability to designate whether tax payments are to be applied to trust fund or non-trust-fund tax liabilities.

Id. at 550.

The decision in *Energy Resources* is pertinent to this case for two reasons: (1) the opinion endorses a broad interpretation of section 105(a) as a source of substantive power that permits bankruptcy courts to issue orders that are not tethered to a specific section of the Code; and (2) the opinion establishes a "plain-meaning" approach to determining whether a section 105(a) order conflicts with another provision of the Code.

The Bankruptcy Code does not explicitly provide bankruptcy courts with authority to issue channeling injunctions enjoining claims by third-parties against non-debtors. However, *Energy Resources* is clear that such an absence of express power does not bar this Court from issuing such an order. *See Energy Resources*, 495 U.S. at 550. Rather, this Court may use its equitable powers pursuant to sections 105(a) and 1123(b)(6) to grant *any* relief, not inconsistent with the Code, with the broad aim of promoting a successful reorganization.

Some courts outside of the Eighth Circuit prohibit non-debtor injunctions under 11 U.S.C. § 524(e).[10] That section provides:

> Except as provided in subsection (a)(3) of this section [(not relevant here)], discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

However, in *A.H. Robins*, the Fourth Circuit Court of Appeals rejected the argument that section 524(e) prohibits non-debtor injunctions, relying on the reasoning of the Fifth Circuit Court of Appeals: "'the statute does not by its specific words preclude the discharge of a guaranty when it

[10] The reasoning of these cases generally originates in *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985).

has been accepted and confirmed as an integral part of reorganization.'" 880 F.2d at 702 (quoting *Republic Supply Co. v. Shoaf*, 815 F.2d 1046, 1050 (5th Cir. 1987)). Specifically, the court noted, *inter alia*, that:

> [W]here the entire reorganization hinges on the debtor being free from indirect claims such as suits against parties who would have indemnity or contribution claims against the debtor, we do not construe § 524(e) so that it limits the equitable power of the bankruptcy court to enjoin the questioned suits.

880 F.2d at 702. This view is supported by the Eighth Circuit decisions discussed above. *See In re Master Mortg. Inv. Fund, Inc.*, 186 B.R. at 938 ("Section 524(e) does not prohibit the issuance of a permanent injunction."); *In re Security Services, Inc.*, 203 B.R. at 712 (same); *see In re Hoffinger Indust., Inc.*, 321 B.R. at 513-514 (implicitly rejecting the argument by recognizing section 524(e) but applying the five-factor balancing test). More importantly, this interpretation of sections 105(a) and 524(e) is consistent with the United States Supreme Court's interpretation of section 105(a) in *Energy Resources*. Just as the Code sections cited by the IRS in *Energy Resources* did not expressly prohibit an order requiring the government to apply tax payments to outstanding trust fund tax debts, section 524(e) does *not*, nor does any other Code section, by its "plain meaning" expressly prohibit an injunction benefiting non-debtors. Numerous other circuit courts agree. *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 985 (1st Cir. 1995); *Robins*, 880 F.2d at 702; *Shoaf*, 815 F.2d at 1050; *In re Dow Corning Corp.*, 280 F.3d 648, 657 (6th Cir. 2002). Accordingly, this Court should exercise its equitable powers under section 105(a) to enjoin Tort Claims against the Catholic Entities and Settling Insurers. Without such injunctive relief, all of the claims affecting the Diocese's Bankruptcy Estate will not be fully adjudicated and administered, and the Diocese will be denied its primary source of revenue which is essential to its reorganization and the continuation of its Catholic ministry.

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Respectfully submitted,

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