Report

The Davenport Bankruptcy and Recent Litigation

by Tom Dybdahl

After the initial excitement surrounding Dr. Donald John Davenport's filing for bankruptcy, and disclosures that Adventist organizations had loaned almost $18 million to the doctor, the matter disappeared briefly from view. But now it has come roaring back, largely due to a class action suit charging the church and several officials with fraud and financial mismanagement. The suit has also brought attention to certain actions and conflicts that had occurred in the preceeding months.

Following Davenport's bankruptcy declaration in July 1981, a hearing was held at the Federal Court in Los Angeles on September 3, 1981. Approximately 70 people attended, about half of them lawyers. Many of the others were Davenport creditors, curious about the fate of their funds.

At the hearing, Dr. Davenport refused to answer any substantive questions about his finances, claiming Fifth Amendment protection against self-incrimination on the advice of his lawyer. However, he did request that his bankruptcy be converted from a chapter 11 filing to chapter 7.*

Davenport's attorney argued for the switch, but four other attorneys spoke in opposition. After briefly considering the request, Judge Barry Russell denied it, suggesting that creditors might have fewer rights under a chapter 7 proceeding and that Davenport's refusal to answer questions might be a block to gathering the necessary information.

Since the bankruptcy filing more than seven months ago, the court-appointed trustee and his staff have been trying to sort out the doctor's finances and to come up with a complete list of his assets and obligations to creditors. The work has been slowed considerably by Davenport's refusal to cooperate with investigators. Meanwhile, the *Los Angeles Times* reported that he has sought permission — unsuccessfully — to resume bidding on post office buildings.

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*Under federal bankruptcy laws, in a chapter 11 filing, after the debtor's finances are reorganized, he may get back on his feet somewhat, and then creditors will collect more — or perhaps even all — of their money. With a chapter 7 filing, assets are simply liquidated and the money is divided among the creditors according to a well-delineated line of succession.

When the Annual Council met in Washington, D.C., October 6 to 14, 1981, denominational leaders took steps to put the church's financial house in better order and prevent another Davenport-type fiasco. The guidelines on conflict-of-interest were tightened, and Audit Review Committees were set up to check on union and conference financial statements.

In addition, the Annual Council set up an Arbitration Steering Committee to "handle equitable distribution of any assets recovered and provide [a] mechanism for arbitrating any disputes arising between church entities." A report on the action in the *Adventist Review* carefully noted that while the Council had agreed to such a committee, the action was "subject to ratification by church entities." The group was to be headed by Kenneth Emmerson, former General Conference treasurer and now a general field secretary, and composed of officers and lay members from the conferences involved with Davenport, as well as officials from the unions and the General Conference.

Church leaders were fearful that without such a committee there might be legal battles between church institutions with conflicting claims to Davenport's limited assets. For example, Davenport had given first mortgages on the post office at La Sierra, California, as security on loans to three different church institutions, and the doctor did not own the property in the first place.

As voted by the Council, the steering committee was empowered to make final settlements and was required to set up an appeal process. Church organizations did approve the idea, and the committee met three times through the fall and winter.

But the most notable result of discussions about the Davenport matter did not appear in any official report of Council actions. Many leaders felt strongly that if the denomination was to retain the confidence of members in the church's financial dealings, anyone who had money in a revocable trust should be paid on demand, even if the funds had been lost in the Davenport bankruptcy. Further, they believed that interest payments on these funds should continue, even if the money was gone. After considerable discussion, a consensus developed that this should, indeed, be the church's policy.* It was made clear that if any conference or union could not repay trust monies because of a lack of funds, the General Conference would work out a loan.

Even as it was being struck, however, this consensus was in jeopardy. On September 17, 1981, Gertrude Daniels, an 85-year-old woman from Yamhill, Oregon, had written to the North Pacific Union asking for her money back. Her lengthy letter to Charles F. O'Dell, director of union trust services, detailed her view of how she became involved with the union.

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In her letter Mrs. Daniels wrote that back in 1970 she had taken money from the sale of her home and from her savings and gone to see Wayne Massengill, then director of North Pacific Union trust services. Rather than simply taking her $10,000, he convinced her to loan the funds directly to Donald Davenport. She did so with the help of the union, and shortly received a note payable to Gertrude Daniels or the North Pacific Union Conference, which she placed in trust with the union. Over the years, she had some qualms about the safety of her funds, but when she contacted the union she was told that everything was fine.

Mrs. Daniels reported that in 1978 her interest checks began to arrive late. When this happened, she would contact Massengill, and payment would follow soon after. But when her yearly interest for 1980 was late, she contacted the union trust depart-

*This was never officially voted, but several participants called it a "consensus" or a "clear understanding." No announcement of this policy was made to the trustors.

ment by phone and told them that she would like to withdraw all her money. They assured her that it was secure, and in April 1981, she received her interest check, though it was a bit short.

Disaster hit in July. She received a note from the North Pacific Union Conference that Dr. Davenport was in financial trouble, followed quickly by a letter from the bankruptcy court in California saying that her money might be lost. Later that summer, she was further disquieted by reports from a friend that the union's lawyer could not help her with any claims because to do so would be a conflict of interest. So she wrote to ask for her money, adding that she was in serious need of cash to take care of some pressing business matters before winter. "I feel bad about having to do and say all the things I have had to in writing this letter," she wrote, "but I knew of no other Christian way to handle the matter and getting the money that is rightfully mine returned to me." Copies of the letter were sent to General Conference President Neal Wilson and the General Conference Insurance Company in Riverside, California.

According to Mrs. Daniels, nearly two months passed before she received a phone call from the North Pacific Union, suggesting that she see the union's attorney, John Spencer Stewart. A meeting was arranged for late November. About the same time, she received a letter from A. J. Patzer on behalf of President Wilson.

Patzer's letter reflected the consensus that had come out of Annual Council. "It is our consistent position that those who entrusted money with the church will get their money back. Church leaders have a sacred responsibility to live up to those responsibilities and return the funds." Then he added: "It is our suggestion that at such a time, you need money, that you contact your conference office."

So Mrs. Daniels met with Stewart. But she reported that after reviewing her situation, he washed his hands of the matter. He told her that the money was gone and that she had no claim on the union. Mrs. Daniels then contacted Ernest Ching, an Adventist attorney from Tustin, California, who was already representing a number of Davenport creditors.

Another retired trustor, 87-year-old Arthur Blumenshein of Arch Cape, Oregon, was having a somewhat similar experience. After Davenport's collapse, he was worried about the $60,000 that he had placed in trust with the North Pacific Union which had then been loaned to the doctor. After pondering the matter, he called Ching. On October 23, 1981, Ching sent a letter to O'Dell, director of the North Pacific Union trust services, on behalf of Mr. Blumenshein, asking for the money plus interest. A response was requested within 10 days.

O'Dell did not respond, but Ching received a call from Stewart in early November, asking for more time to study the situation. Shortly thereafter, Ching said, he received a letter saying the union would give the problem further consideration, but that they did not see things quite the way he did.

Based on these responses, Ching decided to act. On December 16, he sent out a 30-day notice letter to the North Pacific Union Conference, to each of its conferences, and to the General Conference, stating that he intended to file suit on behalf of the trustors who had lost funds in the Davenport bankruptcy.*

Ching received no response from the General Conference, and only another phone call from Stewart, saying again that the union was looking into the matter. An official from the Washington Conference wrote to say only that his conference should not be named in the suit. So on January 22, 1982, Ching filed suit on behalf of Gertrude Daniels, Arthur Blumenshein, Helen Black and others similarly situated.

Meanwhile, the arbitration panel was having problems of its own. Not only was the group struggling to prevent suits among church entities, it soon faced another problem — how to handle insurance claims. Some unions and conferences were considering filing suit against the General Conference In-

*The 30-day notice period is required by Oregon law to provide time for the potential defendants to remedy the problem, and thus avoid the suit.

surance Company (called Gencon Risk Management Service) to try to collect for their losses.

Two Gencon policies were of particular importance. Church officials were covered by Directors and Officers Liability, as well as Trustees Errors and Omissions Liability. There were clear limitations on these policies, however. The directors and officers liability covered only individuals, not organizations. And virtually all Davenport loans had been committee decisions. And the errors and omissions liability was a third-party coverage, and it was unclear whether this policy would make up investment losses. Under this coverage, if a conference or union had lost money, they could probably not collect from the insurance company directly. But if a third party sued a church organization, and won, the errors and omissions policy might be used to cover the loss.

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Because of this somewhat tricky situation, there were widespread suggestions that the North Pacific Union Conference (which had loaned some $6.4 million to Davenport) was deliberately refusing to follow the consensus agreement and return revocable trust monies in an effort to force a suit. The logic was obvious: if they honored the understanding, the Union would have to pay the money; if they lost a suit, there was a chance the insurance company might pay.

Indeed, the whole Davenport matter was putting pressure on the church's insurance company. On January 4, 1982, the president of Gencon, Charles O. Frederick, wrote a five-page letter to the presidents and treasurers of all conferences and institutions in the North American Division, setting forth his views on Davenport-related claims. The letter was not authorized by General Conference officers, and it took some of them by surprise.

In highly charged language, Frederick wrote that "in spite of the approximate $23,000,000 potential investment loss, the church still cannot discipline itself and is headed full throttle down the road toward disastrous litigation between conferences, between conferences and church officers, and between conferences and the church-owned insurance company." He argued that the insurance policies written by Gencon were not meant to cover church investment losses. He recommended that another arbitration board be established to solve the financial problems between conferences and avoid litigation. In his view, the existing committee members "cannot possibly function as an arbitration board," and might face allegations that they were "engaged in a cover-up scheme to protect their own selfish or individual interests."

Frederick made it clear that if any conferences or unions tried to sue Gencon to collect for their losses, the company would fight the claims. However, he suggested that the church "cannot afford to pay the legal fees, which are already astronomical." He recounted at length the benefits that Gencon had brought to the church and what a disaster it would be if the company were threatened. He closed with a flourish:

> If the feedback we have received from the field is correct, it would seem to indicate that the constituency and the majority of church administrators not involved with Davenport are opposed to having the International Insurance Company pick up the tab at their expense. . . . Also, this feedback indicates that greediness for the all-mighty dollar is the source of our trouble with Davenport investments. Also, greediness towards the insurance company for recovery of uninsured losses, without due respect to business ethics and the moral concept of contractual provisions in the insurance policies, is responsible for turning the church toward the entanglement of litigation which may end in disaster. Even the Gentiles know that this may be a disastrous course for the church to

follow. Personally, I hope the brethren will see the light of day and avoid further complications and unnecessary legal expense.

Again, time has almost run out and positive action must be immediately taken to turn the "Davenport Express" around and avoid unspeakable adverse publicity for our church.

While many people felt that Frederick was overstating the case considerably, there were insurance problems. So the arbitration steering committee, at a January 26 meeting in Thousand Oaks, California, set up a second subcommittee on insurance matters to examine claims that had been rejected by Gencon. And this steering committee is working on a policy for dealing with insurance claims from the conferences in a way that will be acceptable to all parties concerned, including Gencon and any other underwriters involved. The goal is to avoid costly litigation among jurisdictions and institutions of the church.

At the same meeting, the consensus on repayment that came out of Annual Council may have been put back together. The North Pacific Union Conference apparently agreed to honor claims from those whose revocable trust monies had been lost to Dr. Davenport. If the union had followed the policy earlier, this suit would never have been brought. It was a bit late.

The class action suit, case #A8201 00413, was filed January 22 in the Oregon Circuit Court for Multnomah County (Portland). Named as defendants were the North Pacific Union Conference and its legal arm, the North Pacific Union Conference Association, as well as all the conferences in the union and their associations, the North American Division and its corporation, and the General Conference and its corporation. Individuals named were former General Conference president Robert Pierson, current president Neal Wilson, Wayne Massengill and Charles O'Dell, former and current directors of North Pacific Union Trust Services, and James Hopps, in-house attorney for the North Pacific Union Conference.

The 19-page complaint was a class action suit on behalf of "all individuals who invested funds with Donald J. Davenport upon the advice and with the assistance of the defendants" and then put their promissory notes in trust with the church, as well as those "whose funds were placed in trust with the North Pacific Union Conference Association and whose funds were thereupon invested with Donald J. Davenport." The plaintiffs asked for $10 million actual damages and $23 million punitive damages.

The complaint charged that the defendants had breached their fiduciary duties by — among other things — having conflict of interest, failing to adequately check the security of the loans, and not informing the plaintiffs of the substantial risks involved. The suit also alleged that the defendants had committed fraud and securities violations, and that trust funds had been "laundered" through Dr. Davenport so they might be used for operating costs. Attached to the complaint were five pages of requests for production of documents from the organizations and individuals named.

As with other church-related court cases, the issue of whether the suit should have been brought at all raised almost as many questions as the issues covered by the suit itself. Here were three Seventh-day Adventists, represented by an Adventist lawyer, suing their church. And there could be no doubt that the suit would cause the church additional public embarrassment.

The plaintiff's lawyer, Ernest Ching, felt that he had no option. Although he represented more than 30 of Davenport's creditors, he stated emphatically that he had "never received anything in writing from the General Conference or their general counsel" about the case. Further, he said that none of his clients had received any notification about the arbitration process that was underway or the apparent policy on repayment of trust monies.

In informal contacts with other Adventist lawyers, Ching said he had made it clear that "under certain conditions" he would be willing to work with an arbitration panel. Subsequently, he was invited to a meeting with church lawyers in December 1981 to discuss

setting up such a group. But shortly before the scheduled time, the meeting was postponed. Since then, neither side has taken the initiative to organize a meeting.

"I don't know what else I could have done," Ching said. "We were getting virtually no response from the church. There was no mechanism set up to resolve the impasse, and no effort made to set one up." He used the case of Mrs. Daniels as an example. "When she was refused payment by the North Pacific Union Conference, she was told only that she had no claim. Nothing was mentioned about an arbitration board or possible appeal."

Finally, Ching felt that he had to file suit soon or the statute of limitations might run out on some of his clients. Davenport's business affairs were highly irregular in many cases, and the doctor had been delinquent on some of his obligations for months or even years. Once the statute of limitations on fraud had expired, creditors would have no legal claim. Ching also saw the suit as a mechanism to get the facts of the situation to all individuals who had trust funds that had been loaned to Davenport, and to insure that they all were treated fairly.

The General Conference was named in the suit for two reasons, Ching said. First, he felt that — despite their warnings about Davenport — the General Conference did have some responsibility. They had audited the North Pacific Union Conference's books, and knew that some investment guidelines had not been followed. If the guidelines had been enforced, there would have been security for all loans. Second, he hoped that the General Conference might be more responsive than the North Pacific Union Conference.

But the litigious climate that had resulted from the Davenport bankruptcy troubled many General Conference leaders. In the February 4, 1982, issue of the *Adventist Review*, Neal Wilson's "From the President" column was titled "Adventists and Litigation." He did not refer specifically to the Davenport fiasco, but it clearly was the catalyst for his comments.

Wilson pointed out that one of the "deplorable practices" Paul condemned in the Corinthians was taking their disputes to court. He quoted Paul's appeal from I Corinthians 6: "When one of you has a grievance against a brother, does he dare go to law before the unrighteous instead of the saints? . . . To have lawsuits at all with one another is defeat for you."

After reviewing the excuses sometimes used for court actions, he asked: "What is the right thing for me to do when I have been, or think I have been, wronged: Do I take seriously the principles outlined in Scripture and the counsel Ellen White gives on how to settle matters, or do I yield to the ways of the world?" He answered: "If there is any other alternative, the court is no place for a Christian." And he raised the point that lawsuits may not only be ill-advised, they may also be sinful. "You can win a court case and lose your soul."

In spite of his strong words, Wilson had left the door slightly ajar with the clause "if there is any other alternative." As the class action suit drags on, honest people will certainly disagree about whether alternatives existed, and about what options might have been pursued.

But one thing is not in doubt. The Davenport affair has brought considerable disrepute to the church, and it continues to do so. The church's goal in this crisis should not be to simply weather the storm, cut its losses, and try to tighten guidelines. The goal should be to develop structures that provide for more openness and accountability, in financial as well as theological matters. Changes like these involve risk, but might have nipped the Davenport disaster in the bud. If we can develop such structures, we will have purchased something valuable with our lost dollars.